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INFORMATION

August 5, 1987

To: Members of the Executive Board

From: The Secretary

Subject: International Capital Markets - Developments and Prospects, 1987

There is attached for consideration by the Executive Directors a paper on developments and prospects in the international capital markets, which has been scheduled for discussion on Friday, September 4, 1987. A paper containing background material on capital market financing for developing countries will be issued shortly. A paper on "Innovations and Institutional Change in the Financial Markets" will be issued subsequently for discussion after the Annual Meetings.

As before, it is planned that a paper in the World Economic and Financial Surveys series be prepared based upon the staff papers. 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

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INTERNATIONAL MONETARY FUND

International Capital Markets - Developments and Prospects, 1987

Prepared by the Exchange and Trade Relations Department

(In consultation with the Research Department)

Approved by L.A. Whittome

August 4, 1987

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I. Overview

The split in international capital market activities that began in 1982 has become even more accentuated in 1986-87. Net lending between industrial countries through the bank credit and bond markets nearly doubled in 1986 to a new peak close to $600 billion, while lending to developing countries came to a halt (Chart 1). Within the group of developing countries, there also was a split in lending activity. Countries without recent debt servicing problems borrowed some $10 billion, in contrast to net repayments of a comparable amount by countries with recent debt servicing problems.

The collaborative approach to debt restructuring has recovered to some extent from the serious setback that occurred in late 1986 and early 1987. That setback reflected difficulties in completing the Mexican package, acrimonious discussion in advisory committees regarding the restructurings for Chile and the Philippines, and the suspension of interest payments on medium-term debt by Brazil. However, the banking community responded with greater technical imagination, and a sense of urgency, to Argentina's request for new money.

Banks noted that the 1986-87 round of financial packages was now quite well advanced, based on progressive expansion of the menu of financing options. In a twelve month period substantial progress has been made in assembling some $10 billion of new commercial bank commitments for three countries--Mexico, Argentina, and Nigeria--along the lines envisaged in the Baker Initiative. Debt restructurings have been finalized or agreed in principle with, among others, Chile, the Philippines, Morocco, and Uruguay, while banks have agreed to allow a debt buy-back by Bolivia. A lead management group of banks has agreed to the term sheet for a loan of $1.1 billion to Colombia--which had earlier made use of concerted financing (while not rescheduling its debt).

For the immediate future, banks raised four principal issues. First, the menu of financing options should be widened further, and in the view of some banks should include the option for limited, voluntary, interest deferment or capitalization. Second, banks intend to press forcefully for actions by debtor and creditor governments that would minimize their own exposure increase. Third, the situation of debtor countries remains vulnerable to external developments, and banks are pressing for official involvement to cushion possible shocks. Fourth, leading banks are keenly aware of the discounts at which loan claims are transacted, and--for various reasons--are building up their reserves. However, with the exception of the proposed Bolivia buy-back and the operation of debt/equity schemes, they presently rule out cancellation of claims on debtor countries.

The outlook for lending to developing countries that have experienced payments difficulties has deteriorated during the past year. The prospects for a resumption of spontaneous general purpose bank lending appear very limited for most of these countries. Notwithstanding progress in the present round of restructurings, there are serious concerns about the difficulty of mustering concerted loans from banks for "nonsystemic" countries.

Three main factors account for these problematic aspects of the present outlook: the uncertain prospects for interest rates and export markets in industrial countries; adverse economic trends in a number of developing countries; and a desire by banks to strengthen their competitive positions by minimizing their exposure to debtor countries. Notwithstanding these concerns, many institutions indicated willingness to engage in a limited volume of new short-term trade and project finance to support the business of major industrial country clients with developing countries. Moreover, recent economic developments in some major debtor countries were viewed as encouraging.

Financial flows among industrial countries virtually doubled in 1986. Widening imbalances in these countries, together with increasingly sophisticated use of international markets, raised activity to historically high levels. Competitive pressures in financial markets remained intense. In part, this reflected increased competition for market-share by institutions entering new activities, as deregulation in several major countries opened up markets to greater foreign and domestic competition.

However, in early 1987, conditions became less buoyant, reflecting interest and exchange rate uncertainties and a major dislocation in the floating-rate note market. Several factors that had stimulated the recent rapid financial growth gradually exerted a lesser influence, as the opportunities to arbitrage borrowing costs diminished, and the pace of innovation in instruments slackened.

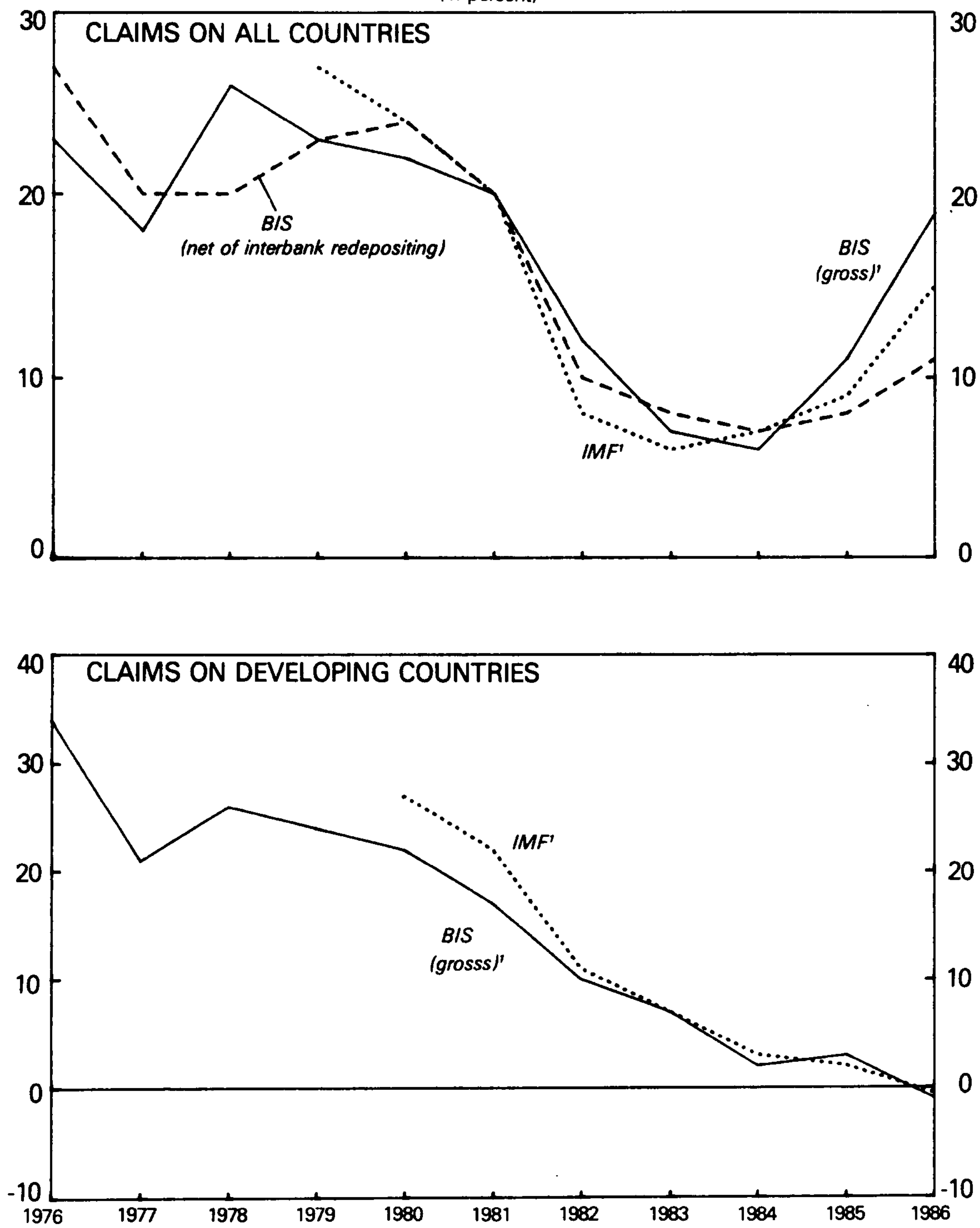
Given the extensive changes that have occurred in domestic and international financial markets in recent years, the authorities in all industrial countries have begun to adapt their supervisory and regulatory framework to reflect better the new financial environment. This has involved further strengthening of bank capital--in particular including off-balance sheet items in the appraisal of capital adequacy--and harmonizing of regulatory conditions across different markets. There is an urgent need to press forward with coordination of the supervision of bank and nonbank financial intermediaries, both within national markets and between markets. The interest rate exposure of banks, and developments in the interbank market, are areas where official surveillance will be most important.

The huge flows among industrial countries raise three main concerns. First, the magnitude of present current account imbalances, and the associated net capital flows, would not appear sustainable over the longer term. Second, while the large gross movements--especially in the interbank market--may reflect mainly arbitraging of market and regulatory conditions, these gross flows are not transparent, and

CHART1

GROWTH RATE OF INTERNATIONAL BANK CLAIMS, 1976-86

(In percent)



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

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

failure in one part of the market could spread by contagion to other sectors--conceivably resulting in an abrupt contraction. Third, the contrast between trade restrictions and financial liberalization has been pointed to as a potential source of instability in financial markets. In the view of most officials and bankers, the key to maintaining sound financial markets lies not in controlling capital flows but in liberalizing trade, in pursuing coordinated economic policies in key currency countries, and in sustaining growth-oriented adjustment in the major developing country borrowers.

The present staff report 1/ includes in Section II an overview of general financial market trends, including recent liberalization measures in the industrial countries, flows between major financial centers, and flows through capital markets to developing countries. Section III reviews progress in managing the debt situation, including the market factors that influence banks' relations with developing countries, and developments in debt restructuring. Section IV examines the progress that has been made in strengthening the system--including the management of debt problems and market risks; the relationship between economic policies and financial market changes is also considered.

As in past years, the paper is accompanied by a background paper which provides additional factual information and analyzes flows to developing countries. A longer term review of financial changes in the industrial countries will be presented, after the Annual Meetings, in the form of a Board paper on the subject of "Innovations and Institutional Change in Financial Markets" (to be issued).

1/ A staff team headed by Mr. C.M. Watson (ETR), and including Messrs. D. Mathieson (RES), G.R. Kincaid (ETR), D. Folkerts-Landau (RES), K. Regling (ETR), and Ms. C. Atkinson (ETR), together with representatives of area departments (ASD and WHD) and the Office in Europe, held informal discussions with commercial banks, securities houses, regulatory and monetary authorities, and international organizations in Belgium, Canada, France, Germany, Hong Kong, Japan, Luxembourg, the Netherlands, Switzerland, the United Kingdom, and the United States in April-June 1987. It should be noted that the term "country" used in this document does not in all cases 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.

II. Financial Markets Trends

1. General developments

Total lending through international bank credit and bond markets nearly doubled to $578 billion in 1986 (Appendix Table 1). In addition, foreign purchases of securities in domestic markets of major financial centers are conservatively estimated to have totaled $170 billion in 1986. During the first half of 1987, issuing activity in international bond markets declined, due in part to heightened uncertainties as to the future course of interest and exchange rates and in part to a sharp contraction in the floating rate note sector following the collapse of the market in perpetual notes. 1/

The surge in total lending in 1986 was entirely due to activity among industrial countries. In contrast, there was a modest net repayment by developing countries. The pace of activity in the banking sector in 1986 was faster than in the international bond markets, reflecting a rapid expansion of interbank activity associated with the growth of international business in the main financial centers. With the major sectoral surpluses in the private sector of industrial countries, fiscal deficits were financed in both domestic and foreign markets, fueling a sustained expansion in public sector debt instruments (Appendix Table 2). Interest rates in 1986 declined to their lowest level since 1978 (Chart 2), encouraging new issues of international bonds, in part to prepay existing debt (Appendix Table 3 and Chart 3).

In 1987, external imbalances among industrial countries are estimated to have stabilized, although at very high levels. The rapid growth of private sector flows through international capital markets came to a halt during the first half of 1987, and imbalances were intermediated to a larger extent by official intervention in foreign exchange markets.

Developing countries repaid net $2 billion to private creditors through international bank and bond markets in 1986, notwithstanding the near doubling in these countries' aggregate current account deficit to about $48 billion. This larger deficit was financed by long-term flows from official creditors and foreign direct investment; there was a much slower accumulation of foreign assets by both the public and private sectors.

However, these developments masked rather divergent trends between fuel and nonfuel exporting developing countries. The current account position of the former swung from a small surplus in 1985 to a deficit of $36 billion in 1986, and these countries drew heavily on foreign

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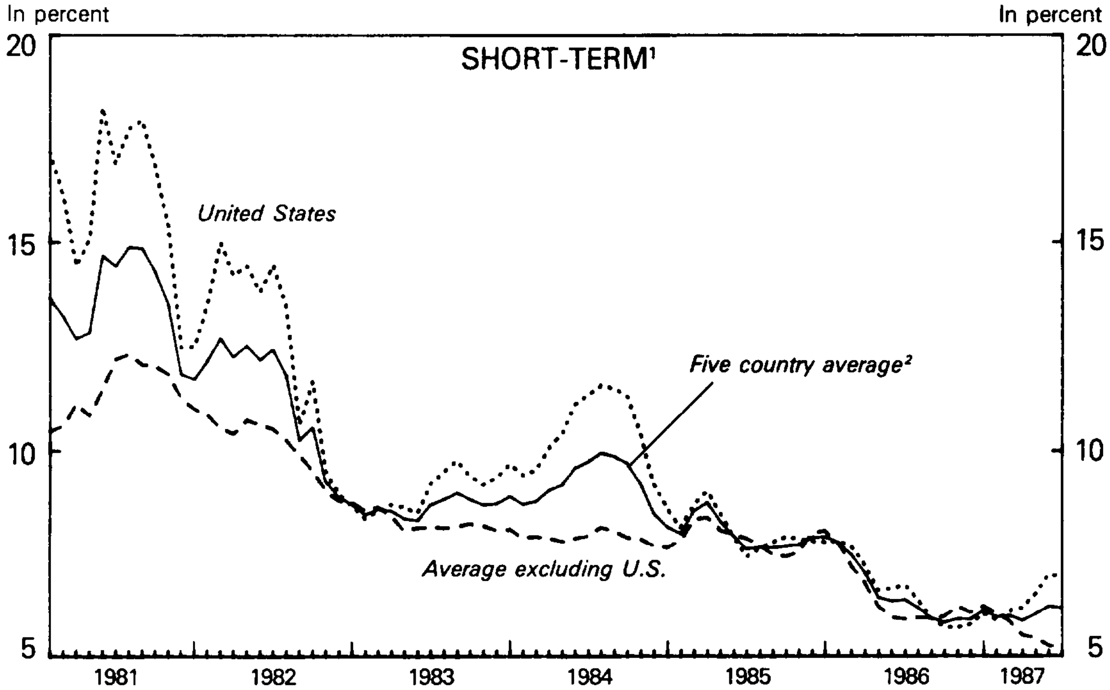
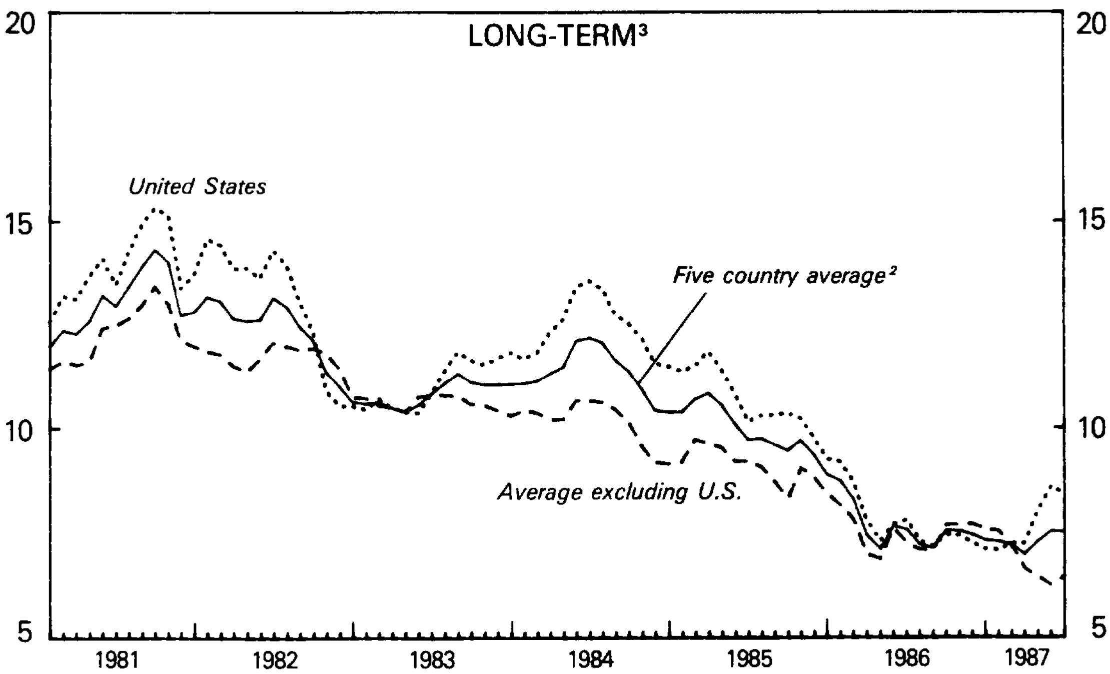
1/ Developments in international bank lending during the first quarter of 1987 will be discussed in "International Banking Activity--First Quarter 1987" (forthcoming).

CHART 2

FIVE MAJOR INDUSTRIAL COUNTRIES

NOMINAL INTEREST RATES, JANUARY 1981-JUNE 1987





Sources: *World Economic Outlook;* Fund staff estimates.

[1] Monthly averages of daily rates on money market instuments of about 90 days' maturity.

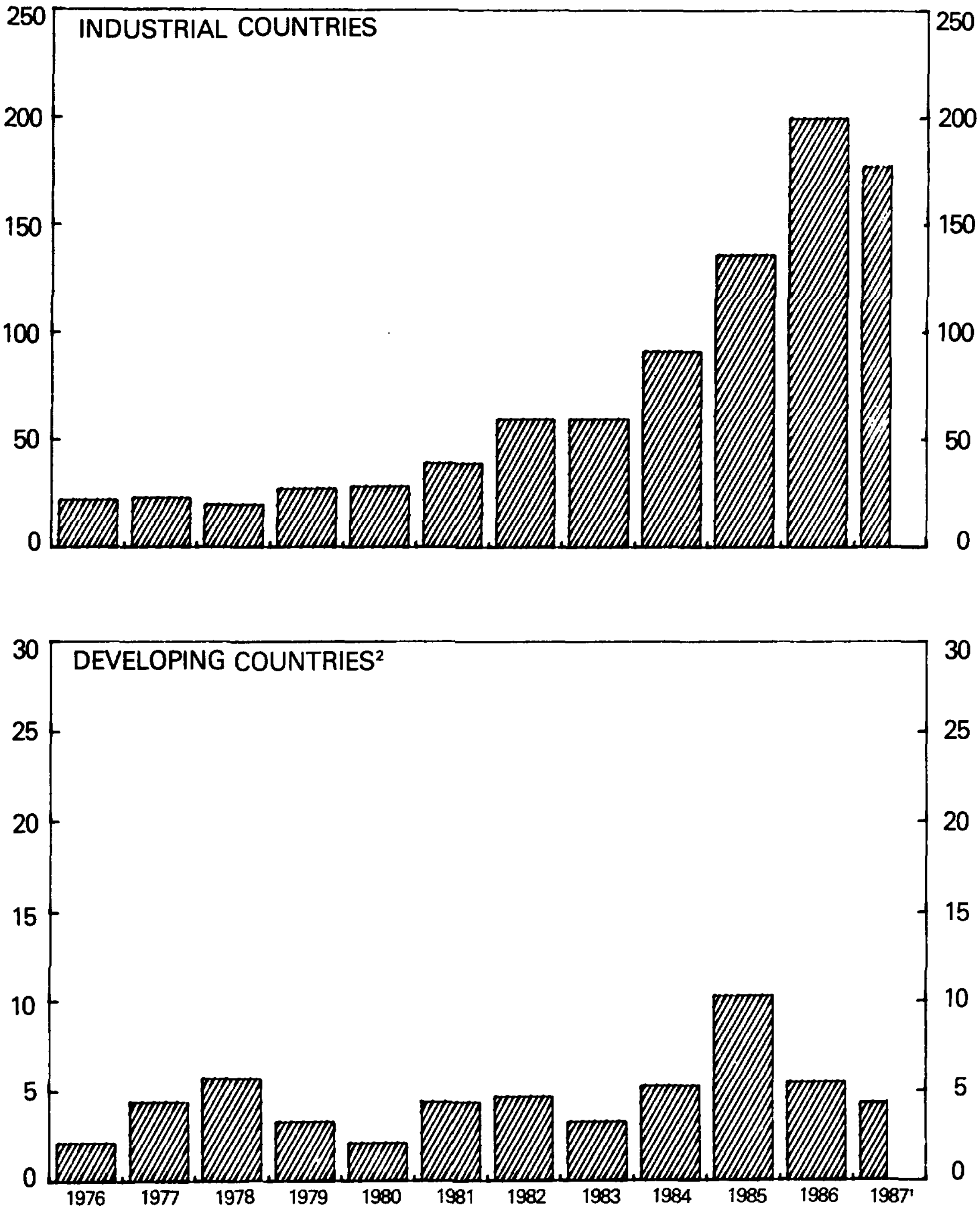
[2] France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States.

[3] Monthly averages of daily or weekly yields on government bonds, with maturities ranging from 7 years for Japan to 20 years for the United Kingdom and the United States.

CHART 3

GROSS INTERNATIONAL BOND ISSUES, 1976-FIRST HALF OF 1987

(In billions of U.S. dollars)



Sources: Organization for Economic Cooperation and Development, *Financial Statistics Monthly*.
[1]First Half annualized.
[2]Including Offshore Centers.

assets, while continuing to make modest net repayments to banks. The current account deficit of nonfuel exporting countries was more than halved to $12 billion in 1986. Their net borrowing from private sources fell to a negligible amount as the smaller current account deficit was more than financed by foreign direct investment and long-term borrowing from official creditors.

For 1987, the aggregate current account deficit of the developing countries is projected to improve with the firming in oil prices. Foreign direct investment is estimated to cover one third of the current account deficit, while long-term borrowing from official creditors is expected to be sufficient to supply the remainder of the external savings. Private sector flows to these countries are expected to increase somewhat over 1986, due to higher disbursements from concerted financial packages.

2. Industrial countries

Four key developments have dominated industrial country capital markets in 1986-87. First, the process of financial liberalization has continued to spread, driven by concerns in certain countries to stimulate competition, and in others to avoid loss of business to other major centers. Second, reflecting this progressive liberalization, and large sectoral imbalances between industrial countries, gross flows have expanded dramatically. Daily transaction volumes have reached new peaks, straining some settlement systems. Third, as activity continued to surge in the three main centers--Tokyo, New York and London--massive interbank flows were channeled into and between these centers, both to finance securities activities and to arbitrage borrowing opportunities. Finally, in late 1986, the perpetual floating rate note market collapsed, seriously damaging the remainder of the floating rate note sector. Some key aspects of these developments are set out below, while implications for financial market stability are reviewed in Section IV.

Liberalization of financial markets continued to spread throughout the industrial economies during 1986-87. In the United Kingdom, a major restructuring of the domestic and international capital markets--the Big Bang--was initiated under the Financial Services Act to create broader and more efficient markets for the securities and investment industries. The Stock Exchange and gilt-edged market were reorganized and domestic and international securities markets merged. Self-regulatory organizations were established to oversee prudential aspects and ensure investor protection.

In France, the authorities abandoned quantitative controls on credit for the conduct of monetary policy. The maturities of public sector debt instruments were broadened significantly, and hedging possibilities in French francs were enhanced by the new financial futures and options markets. Exchange controls were virtually abolished to allow enterprises more flexibility in foreign exchange operations.

The Italian authorities have greatly reduced foreign exchange regulations, and have liberalized portfolio investments abroad. Competition in domestic markets has been enhanced by deregulating interregional banking and allowing commercial banks to create merchant banking subsidiaries. Within the EC more generally, the objective of achieving the free flow of financial services and movement of capital by 1992 received impetus from the 1985 White Paper on "Completing the Internal Market" by the EC Commission. The proposals contained in this paper are now in the process of being implemented by member states.

In Canada, a major liberalization of the financial system has been initiated to abolish the previous separation of activities of banks, securities houses, trust companies, and insurance companies. Federal regulatory authorities are being merged under a single Inspector General of Financial Institutions.

In the United States and Japan, the segmentation of activities between securities firms and banks was further eroded. The U.S. authorities permitted banks to underwrite commercial paper. The Japanese authorities allowed foreign banks to participate in security affiliates in Tokyo. Japanese firms were allowed to trade on their own account in financial futures and options on the foreign exchange markets. In June 1987 a further package of liberalization measures in Japan was announced; this included the intention to establish a domestic commercial paper market and the introduction of auctions for long-term government bonds. A sizeable Japan Offshore Market has come into being; it does not at present include securities transactions.

Gross capital flows among the industrial countries rose sharply due to larger financial imbalances and greater liberalization. These gross flows were also influenced by arbitrage of remaining regulatory barriers and by portfolio preferences of the private sector. The two largest surplus countries have emerged both as major borrowers and lenders of short- and long-term funds. The influence of institutions in these countries over the pattern of private capital flows--and the impact of these on interest and exchange rates--thus far exceeded the size of their current account surpluses. In 1986, Japanese long-term capital outflows--a high proportion of which took the form of securities transactions--reached $131 billion. In addition to its own surplus savings, Japan borrowed $57 billion in short-term funds--largely through banks, in part to obtain funding on terms not available under present institutional arrangements in Japan and in part to finance purchases of foreign securities.

Notwithstanding the doubling in its current account surplus to $36 billion, Germany experienced a record net inflow of long-term capital of $17 billion. Nearly all the gross bond issues of the German Government in 1986 were purchased by foreign investors, while foreign investment in private sector bonds and equities also reached unprecedented levels. Germany experienced large short-term capital outflows of $47 billion in 1986; most of these reflected deposits by banks and nonbanks in Germany with banks in the Euromarkets. Gross banking flows in and out of the United Kingdom and the United States tripled to $310 billion in 1986, partly reflecting their roles as international financial centers.

The flow of bank lending between industrial countries, which doubled during 1986 to $395 billion, 1/ was dominated by an expansion of interbank claims, principally on borrowers in the major financial centers (Appendix Tables 4, 5, and 6). A number of factors may account for the expansion of interbank market activity. One was the funding by bank head offices of increases in bond 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. A large jump in interbank positions occurred in the fourth quarter due to the opening of the Japan Offshore Market at the beginning of December; its total assets reached almost $100 billion by end 1986--about one quarter of the total external claims of banks in Japan.

Banks in Japan more than tripled their interbank borrowing in 1986, reaching $148 billion or 40 percent of interbank activities between the industrial countries. Borrowing activity by Japanese banks outpaced their depositing, with banks in Japan being the largest net absorbers of interbank resources in 1986. Banks in the United States cut nearly in half their net absorption of interbank funds in 1986, as three quarters of the U.S. current account deficit was intermediated through securities transactions. More than one quarter of these transactions were purchases by foreign governments and central banks, reflecting inter alia heavy intervention in U.S. dollars.

International bond issues by borrowers from industrial countries were driven forward in 1986 by favorable refinancing conditions and attractive interest rate and currency swap opportunities. Gross issues rose by nearly 50 percent to $200 billion in 1986--more than triple the volume in 1983--accounting for a record share of market activity (Appendix Table 7 and Chart 4). Refinancing activity in the international bond market nearly doubled to $41 billion in 1986, as borrowers exercised call provisions in view of the sharp decline in interest rates and margins. Notwithstanding the volume of refinancing, net international bond issues 2/ reached record levels, rising to $161 billion in 1986. During the first half of 1987, refinancing activity slowed; gross issuing activity slackened to an annualized rate of $172 billion; and net bond issues declined to an annualized rate of $142 billion.

New issuance of fixed interest rate bonds grew by nearly 60 percent to $147 billion in 1986, accounting for 65 percent of all issues

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1/ A 20 percent increase in the stock of claims.
2/ Gross issues less refinancing and scheduled amortizations.

(Appendix Table 8 and Chart 5). Approximately 20 percent of total bond issues were swap-related in 1986, with activity in some smaller currency sectors being almost totally swap driven. Outstanding interest rate swaps of U.S. banks and foreign banks in the United States more than doubled in 1986 to about $480 billion. During the first quarter of 1987 fixed interest rate bond issues advanced further to an annual rate of $194 billion, while the share of U.S. dollar instruments fell sharply (Chart 6).

New issues of floating rate notes declined in 1986 to $51 billion, primarily due to a smaller volume of issues by developing countries (Appendix Table 9). Activity in the floating rate sector of the international bond market has been sharply curtailed since December 1986 due to the collapse in the market for perpetual floating rate notes, which were issued by banks as primary capital; these instruments were, however, priced as money market instruments and not as equity instruments. A total of $19 billion perpetual floating rate notes were outstanding in 1986. A large proportion of these instruments was reportedly held by Japanese financial institutions.

Market making in these instruments virtually ceased from December 1986 as prices fell sharply, and liquidity vanished. According to market participants, this development reflected typical "overshooting", as illusions about liquidity built up and then collapsed--at which point it became apparent that nonbank investor demand for these instruments had been negligible. A contributory factor may have been rumors that bank supervisors in additional industrial countries were considering applying to these notes capital costs that would avoid "double leveraging" of the international banking system (i.e., banks holding each others' capital). The market for dated floating rate notes was adversely affected by these developments. Issues of floating rate notes declined to $3 billion during the first quarter of 1987, the smallest issuance activity since 1982.

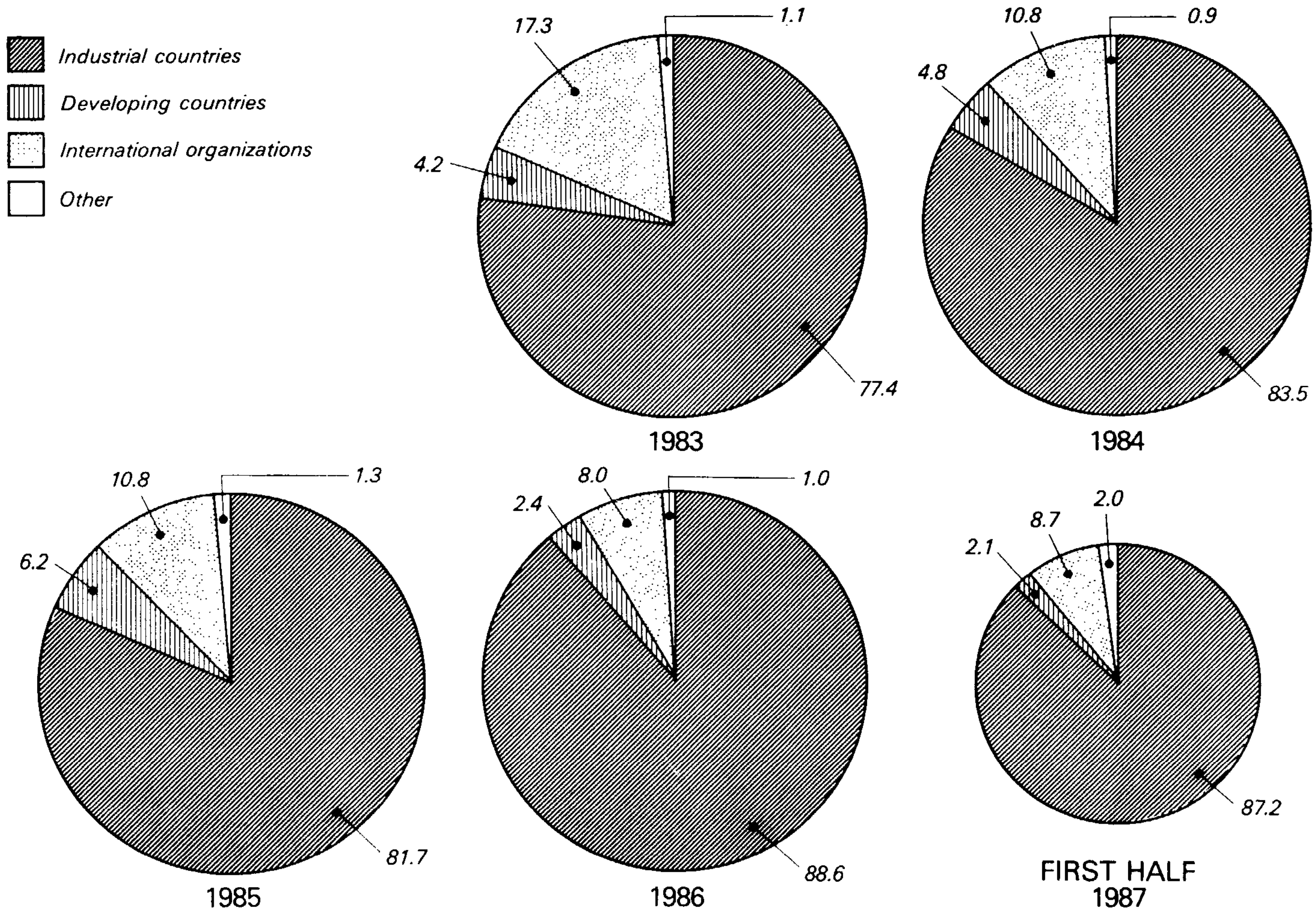
The growing importance in international bond markets of the practice of combining interest rate and currency swaps with fixed rate bonds means that the type of bond issued by a borrower is not necessarily a good indicator of either the currency composition or interest rate structure of the debtor's ultimate debt servicing obligations. In the absence of substantial improvements in the collection of information on swap transactions, the problem of interpreting flow data is likely to grow; in addition, disclosure rules in corporate accounts may need to be strengthened in this area.

Medium-term borrowing facilities, which were largely non-underwritten Eurocommercial paper programs (ECP), and short-term notes facilities (which were largely underwritten) expanded by a third in 1986 to $92 billion. During the first five months of 1987, however, they reverted to about the level of 1985. The share of ECPs in total medium-term facilities increased from 16 percent in 1985 to 61 percent in 1986 and in the first quarter of 1987. This increase in the share of

CHART 4

INTERNATIONAL BOND ISSUES BY GROUPS OF BORROWERS, 1983-FIRST HALF 1987

(In percent)

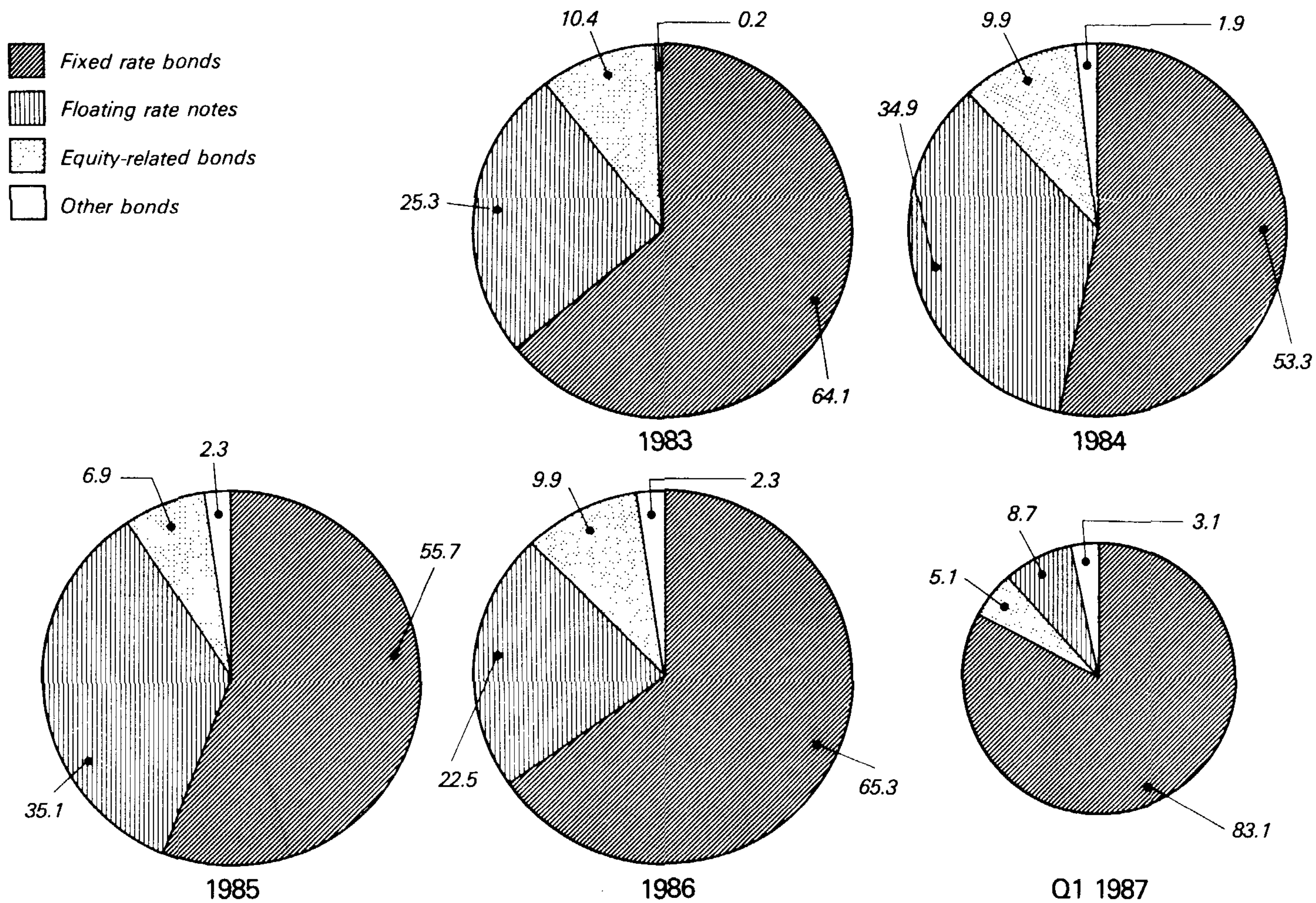


Source: Organization for Economic Cooperation and Development, *Financial Statistics Monthly*.

CHART 5

INTERNATIONAL BOND ISSUES BY MAJOR INSTRUMENTS, 1983-FIRST QUARTER 1987

(In percent)

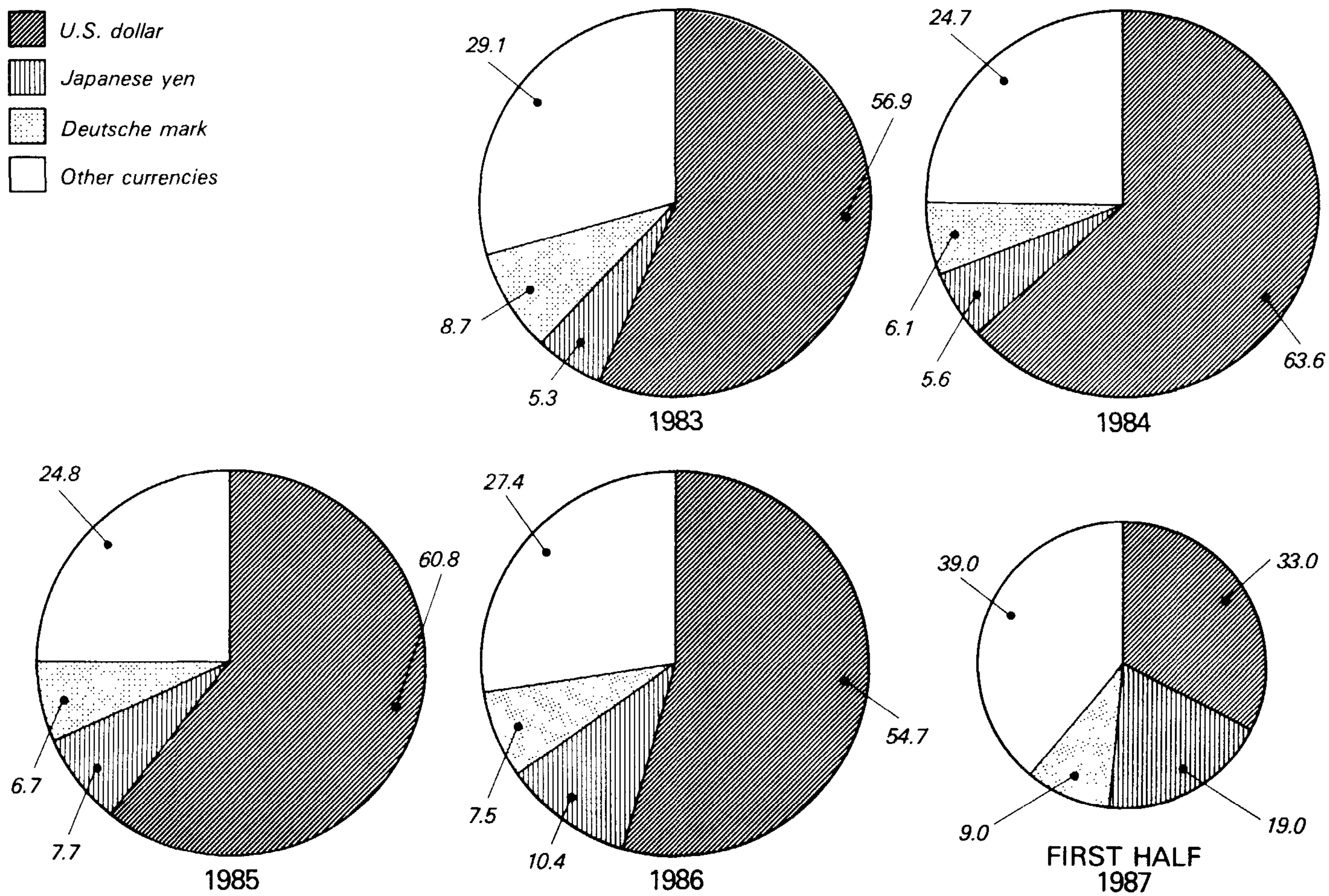


Source: Organization for Economic Cooperation and Development, *Financial Market Trends*.

CHART 6

CURRENCY COMPOSITION OF INTERNATIONAL BOND ISSUES[1] 1983-FIRST HALF 1987

(In percent)



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

[1] Based on exchange rates prevailing at time of issue.

non-underwritten ECP was due in part to the lower costs of ECP--one factor in which was the decision of bank supervisors in major centers to include underwriting commitments on facilities in the calculation of banks' capital adequacy ratios.

The international equity markets have recently expanded at a faster rate than international debt markets. Companies have generally used these markets to broaden their investor base; to avoid domestic taxes, issuing and listing fees; and to arbitrage differential returns on equities in major markets. The issue of equity-like instruments such as nonvoting participation shares and of depository receipts 1/ rose from $3 billion in 1985 to $8 billion in 1986. Given these market conditions, the volume of equity-related bond issues (both convertibles and bonds with equity warrants) doubled to an annual rate of some $20 billion in 1986 and the first half of 1987 (Appendix Table 10). About half of equity-related issues were issues with equity warrants for Japanese borrowers. But this rapid growth in issuance involved substantial "round tripping"--circular flows to arbitrage domestic and foreign financial conditions.

3. Developing countries

Developing countries, excluding offshore centers, made net repayments of $4.2 billion to international banks in 1986, equivalent to a shrinkage of nearly 1 percent, as measured by exchange rate adjusted changes in the stock of bank claims on these countries--which was $587 billion at end 1985 (Appendix Table 11). This contrasts with net lending of $8 billion--or 1 1/2 percent--in 1985. Net repayments occurred in all regions except Asia. The 15 heavily indebted developing countries repaid net $3.5 billion in 1986, compared with net repayments of $1.4 billion in 1985. Actual repayments were concentrated during periods when countries were not pursuing internationally endorsed economic programs. This net repayment includes a reduction in claims on developing countries through officially recognized debt conversion schemes of $1.6 billion in 1986 (Appendix Table 12).

Data on changes in bank claims may overstate actual net repayments to banks by developing countries because of, inter alia, unrecorded bank purchases of bonds and internal write offs of bank claims. These transactions reduce banks' reported claims, but do not involve a cash repayment to banks. After allowing for these factors, the flow of net lending from banks to developing countries is still estimated to have been slightly negative in 1986. Moreover, new official export credit guarantees are believed to have covered a portion of the gross new bank

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1/ A registered stock is deposited with a depository and the depository receipts are then traded in another market.

lending that did take place. 1/ Overall, banks' risk exposure to developing countries thus declined in 1986, but probably by less than 1 percent.

Net bank lending to developing countries without recent debt servicing problems amounted to $6.8 billion in 1986, compared with lending of $8.2 billion in 1985. A few developing countries in Asia and Europe with strong external positions and access to spontaneous finance reduced their bank debt: Korea, Malaysia, Thailand, and Portugal repaid net $5.5 billion in 1986, compared to net borrowing of $0.4 billion in 1985. Fuel-exporting countries drew heavily on accumulated deposits with banks to finance their current account deficits and to make net retirements of bank debt. New spontaneous bank credit commitments to developing countries increased slightly to $16.7 billion in 1986, but amounted to an annualized rate of only $12.2 billion during the first five months of 1987 (Appendix Table 13 and Chart 7).

Disbursements under concerted lending packages declined further to $3.1 billion in 1986 from $5.4 billion in the preceding year (Appendix Table 11). About 85 percent of these disbursements went to five countries in the Western Hemisphere (Argentina, Chile, Colombia, and Panama), while the remainder was disbursed to the Philippines. However, commitments signed or agreed in principle under concerted packages--excluding bridge loans--rose to $8.1 billion in 1986 from $2.2 billion in 1985, largely accounted for by the $7.7 billion package for Mexico. During the first six months of 1987, disbursements of concerted finance were $3.5 billion (mainly to Mexico), more than in all of 1986; a new concerted commitment to Argentina amounted to $1.95 billion.

The trend toward lower spreads on new loans to developing countries continued in 1986 and in early 1987 (Appendix Table 14 and Chart 8). A continued lowering of spreads and lengthening of maturities occurred in concerted bank packages. Spreads on restructuring agreements and concerted loans averaged about 96 basis points during 1986 and the first half of 1987, and maturities on restructured debt averaged 15 years.

Gross international bond issues by borrowers in developing countries, including offshore centers, fell from $10.3 billion in 1985 to $5.5 billion in 1986 and an annualized rate of $4.3 billion in the first half of 1987 (Appendix Table 15). Developing countries share in total gross international bond issues in 1986 (2 1/2 percent) was the smallest in over a decade. The number of developing countries issuing international bonds declined from 22 in 1985 to 19 in 1986 and to 13 in the first half of 1987. Developing country access in 1987 may have been adversely affected by the serious damage to the floating rate sector. Issuers included Colombia, which has arranged two issues since

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1/ An accompanying paper on officially-supported export credits describes export credit policies and provides data on the share of outstanding bank claims that have been guaranteed.

CHART 7

BOND ISSUES AND LONG-TERM COMMITMENTS OF CREDITS AND FACILITIES TO CAPITAL-IMPORTING DEVELOPING COUNTRIES, 1981-JAN-MAY 1987

(In billions of U.S. dollars)

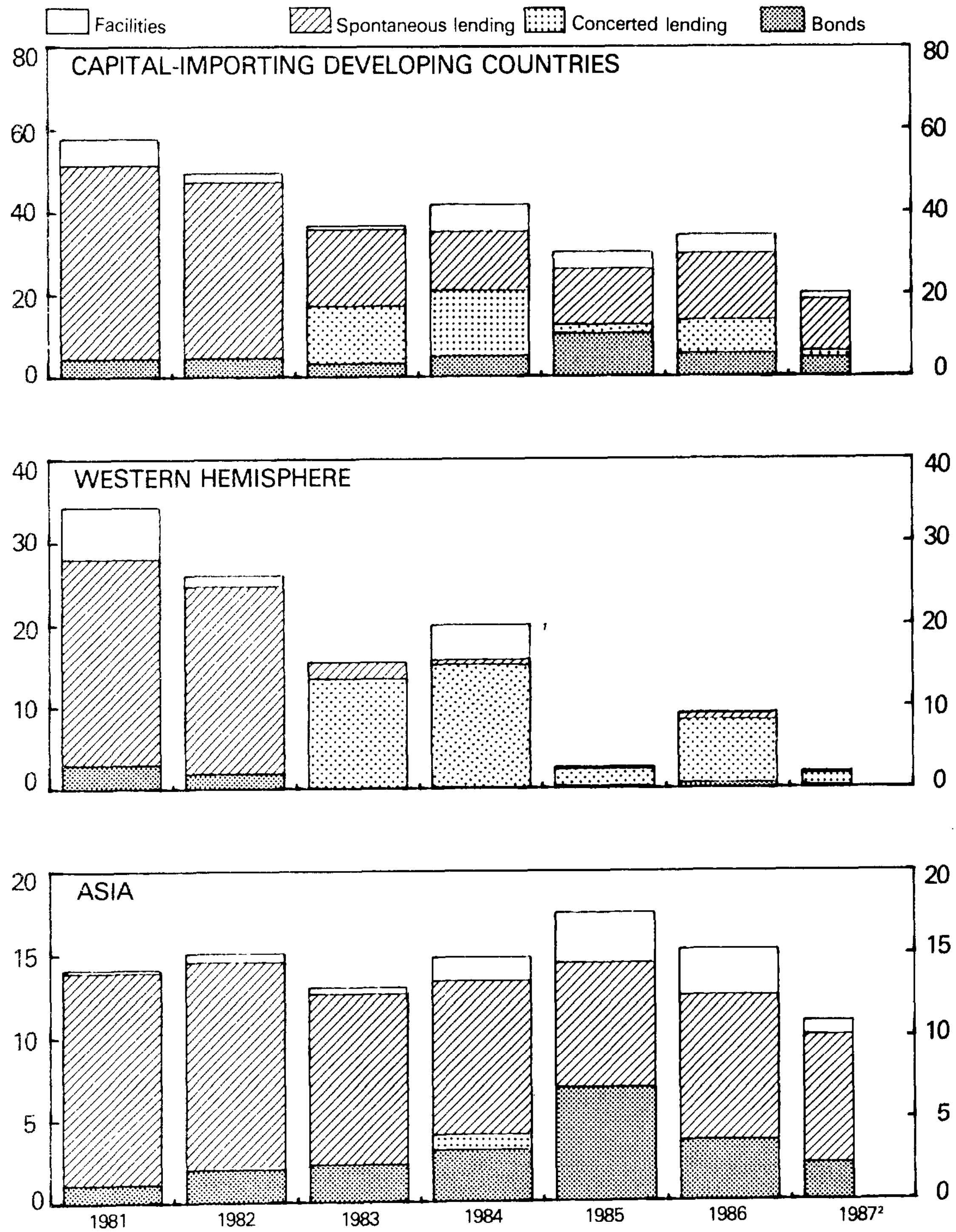
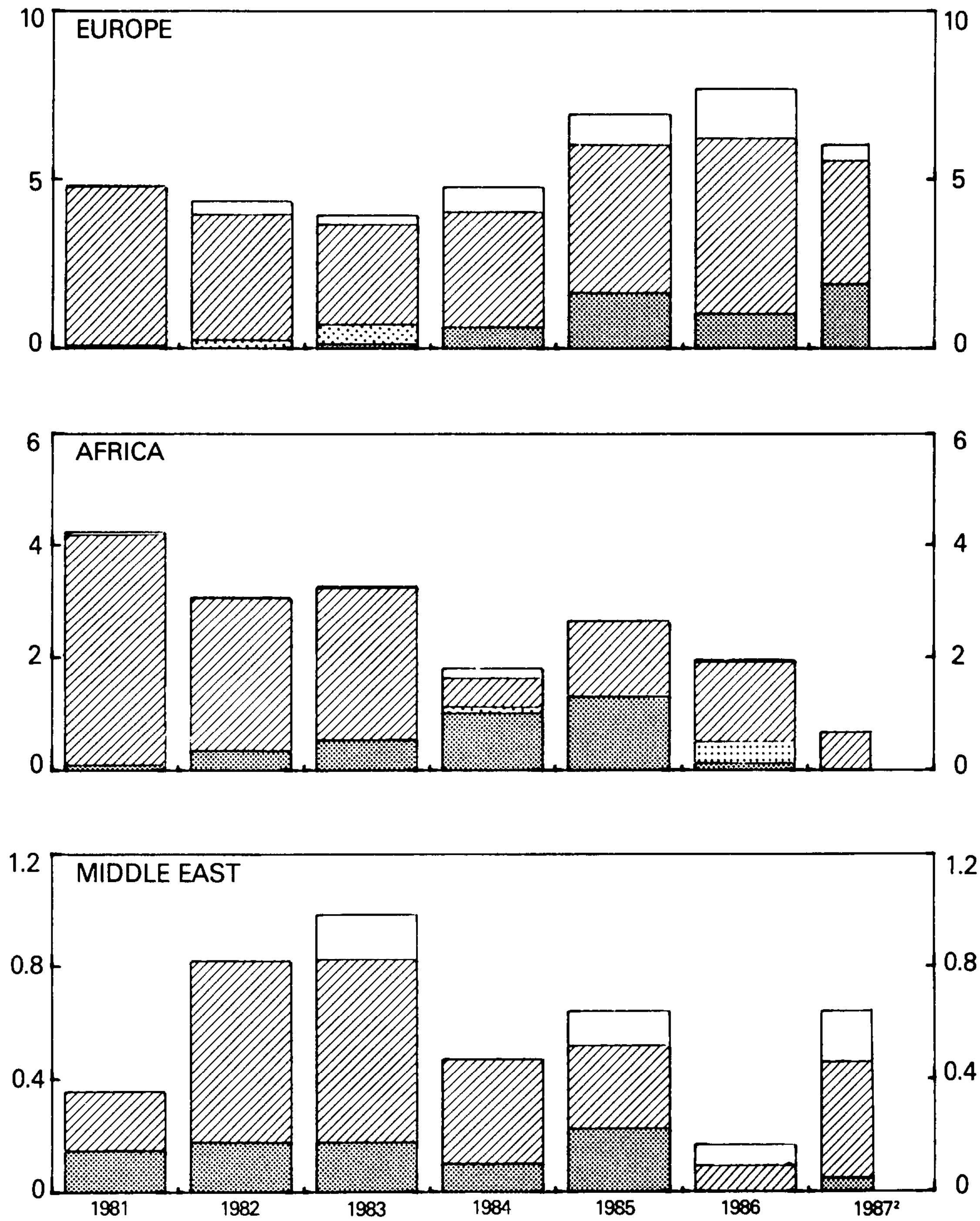


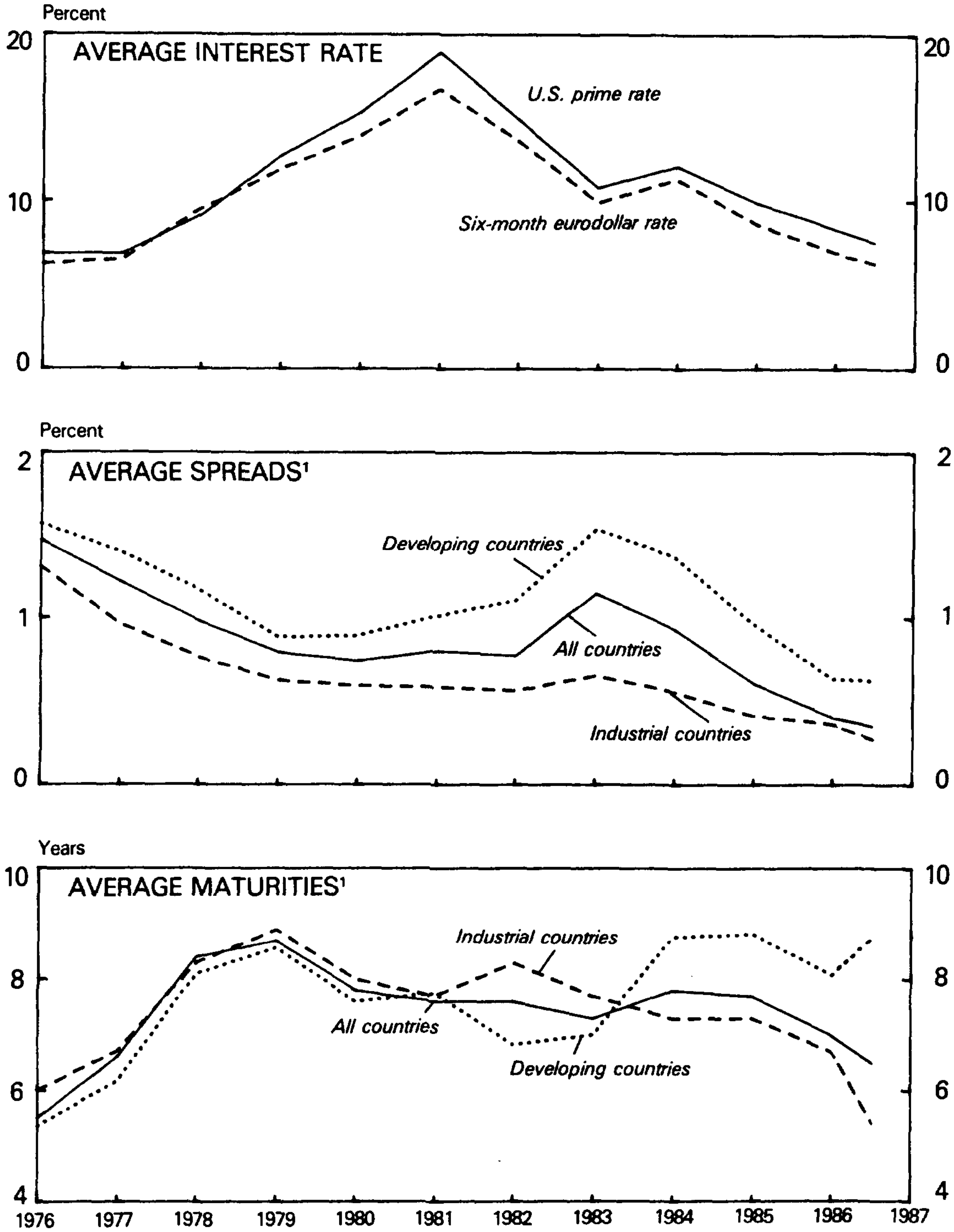
CHART 7 (continued)



Sources: Organization for Economics Cooperation and Development, *Financial Statistics monthly;* and Fund staff estimates.
[1]Includes a facility arranged for Mexico.
[2]First five months annualized.

CHART 8

TERMS ON INTERNATIONAL BANK LENDING COMMITMENTS, 1976-FIRST QUARTER OF 1987



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

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

January 1986. Brazil and Mexico issued about $0.5 billion in international bonds, which represented securitization of existing interbank lines.

Banks with different nationality of ownership exhibited varied behavior in lending to developing countries (Appendix Table 16). In 1986, U.S. banks' claims on developing countries fell by $14 billion or 9 1/2 per cent. All categories of U.S. banks reduced their claims on developing countries in all regions. U.K. banks' claims on developing countries--unadjusted for exchange rate changes--rose by 1 percent in 1986. These banks' claims on the Western Hemisphere increased slightly, while they reduced their claims on Asia and the Middle East and maintained roughly constant their claims on Africa and Europe.

German banks' claims on developing countries--adjusted approximately for exchange rate changes--appear to have declined somewhat in 1986, due almost solely to a decrease in claims on the Western Hemisphere. Although detailed geographical data are not available on banks in other industrial countries, it can be inferred that lending by Japanese banks offset partially the drop in U.S. bank claims on developing countries, especially in Asia.

III. The Debt Situation

1. Market factors

In discussions with staff, banks stressed that progress in resolving debt problems would be crucially dependent on the success of policies to achieve sustained expansion in the major industrial countries, and on the implementation of growth oriented adjustment policies in developing countries. However, growth in world trade, lower interest rates, adjustment in many debtor countries, and successive financing packages, have not unlocked significant spontaneous financing. The key reason for banks' continued aversion to generalized exposure increases lies in a lack of confidence that most debtor countries will be able to sustain, over an extended period, policies sufficiently strong to restore their full creditworthiness, given the downside risks in the economic policy environment in the industrial countries.

In a financial market environment characterized by high liquidity and intense competition, banks are seeking to maximize post tax returns on equity, to adjust their balance sheets to safeguard or enhance their credit standing, and to expand lines of business that minimize absorption of capital resources. Increases in book claims on countries in payments difficulties--as on troubled domestic sectors--appear uncertain in terms of risk adjusted returns; problematic in terms of the market's evaluation of banks' liabilities; and expensive in terms of capital cover. These concerns have continued to strengthen, despite a very substantial dilution of banks' exposure to the rescheduling countries, reflecting higher capital, increased provisions, for non-U.S.

banks a sharp decline in the value of dollar-denominated claims in terms of domestic currency capital, and for U.S. banks a decline in claims.

Discussions with banks on prospects for lending to developing countries indicate that it remains appropriate to make distinctions among banks according to their regional situation, the scope of their existing involvement in developing countries, and their tax and regulatory regimes. Over the past five years there has been a continued trend toward regionalization of business interests, partly in reflection of trade flows. Quite a number of banks of various sizes, keen not to lose business of key industrial clients, would be prepared to take on very modest amounts of risk exposure on a few developing countries in their region--sharing the risk with customers and with national export credit agencies. Also, a number of large international banks retain strong continuing interests in a wide range of developing countries, due to industrial clients' activities or to local financial operations. But, for the present, these interests continue to be structured in ways that seek to avoid increases in unguaranteed cross-border exposure.

The secondary market in loan claims reflects portfolio rationalization in light of these factors. The total volume of transactions on this market through mid-1987 reportedly amounts to $10 billion. Discounts on the debt of most countries have widened recently. The average discount on the 15 heavily indebted developing countries was reported to be between 40 and 45 percent in July 1987, although activity was extremely thin. Within that group of countries the discounts ranged from about 20 percent to 90 percent. Several countries continue to cluster at discounts of about 30 percent, while claims on another group (including the three major debtors) are quoted at discounts in excess of 40 percent. A number of banks and investment houses--notably in New York or London--have developed a role as intermediaries in transactions of loan claims.

Banks described the market as characterized by limited supply and demand. On the supply side, banks with larger exposures have been reluctant to transact a part of their portfolio at prices that may prejudice the valuation of their remaining assets. The recent increase in loan loss reserves against claims on debtor countries may have influenced the price level, since it was perceived to increase banks' flexibility in engaging in such sales. Smaller banks--particularly in continental Europe and the United States--have sought to reduce exposure to countries with debt servicing difficulties through selling these assets at a loss. And banks more widely have consolidated their assets in a smaller number of countries, through exchanges of loan claims.

Demand has mostly come from residents of countries whose debt is trading at a discount, and from institutions and corporations with business interests in a particular country that they wish to finance with the local currency proceeds of converted loan claims. Private investor demand in the secondary market for sovereign debt has been virtually nonexistent. The implicit yield on these discounted sovereign loans is thought by some analysts to inhibit, of itself, new investment in debtor countries. 1/

Significantly greater international convergence in provisioning for loan losses transpired in May-June 1987. Following the suspension of interest payments by Brazil, a number of U.S. banks moved these loans to a non-accrual basis, and subsequently increased their loan-loss reserves to cover some 20-30 percent of exposure to countries experiencing payments difficulties. In contrast to practice elsewhere, these reserves are not tax deductible but may be included in primary capital. The spread of these levels of provisioning in the United States was due not primarily to new pressure from auditors or supervisors, but to banks' concern about market perceptions of their asset quality and a desire to strengthen their competitive position vis-a-vis other banks. This move has been followed by some banks in the United Kingdom and is being studied by many banks in Canada and Japan. Banks observed that provisioning levels may be converging toward those in continental Europe, i.e., some 25 to 35 percent.

Questioned about the implications of this spread of provisioning, banks made four main points. First, to the extent these measures were motivated by competitive pressures among banks to improve their relative standing in debt and equity markets, they would not have a decisive impact on the present round of financing packages. Banks' basic debt approach might initially remain rather similar: they would seek to improve the quality of these assets by avoiding a generalized deterioration of the debtor countries' payments status, pressing for policy reforms, and obtaining as much creditor government financing as possible.

Second, provisioning would increase banks' flexibility--as regards scale and timing--in disposing of loan claims at a discount. Third, notwithstanding some public statements to the contrary, banks expected that they might be constrained by market forces to increase their reserves in line with future exposure increases; in the view of some banks this might, over time, lead to an environment less favorable to new lending. Fourth, banks emphasized that these provisions carried no implications of a willingness to forgive debt, but they admitted to uncertainty about their impact on the perceptions of debtor countries.

During the past year a further important change, supportive of provisioning, has been some convergence in tax regimes applied to general provisions against country risk. 2/ Exceptions to this trend toward greater deductibility would appear to include principally Belgium

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1/ See, for example, An Analysis of the Debt Crisis, WP/86/14, 12/2/86).

2/ As part of tax reforms several countries moved, also, to tighten the regulations that permitted tax-sparing on lending to selected developing countries (a subject discussed in the accompanying background paper).

and the United States. In the United Kingdom, banks were able to establish deductibility of certain specific provisions. In Japan, the regime was not altered, but banks transferred some loan claims--at a discount--to an offshore company in the Cayman Islands, and the losses so incurred were deemed tax deductible. In France, deductibility was reaffirmed, on a substantial scale. In Canada country risk provisions were expected by banks to be exempted from the general tightening of rules on the deductibility of loan loss reserves proposed in June 1987.

2. Debt restructuring

During recent months, the senior management of leading banks have been reviewing ways to improve the working of advisory committees. While this review is likely to be a continuing process, a number of provisional conclusions have emerged. In particular, periodic exchanges among senior officials of leading institutions may be necessary to cut through specific problems and maintain momentum in the restructuring process. As regards advisory committees, a significant expansion of their size, or a rotation of the chairmanship, could be counter-productive. However, committee members in some cases need to strengthen their efforts to involve other banks, both in their own country and in other countries that they represent.

Banks pressed strongly for greater involvement of advisory committees in negotiations relating to the size and distribution of financing gaps. For example, the economic subcommittee of the bank advisory committee might be involved at an earlier stage in the preparation of the financial program. More experienced bank officials involved in rescheduling recognized, however, that there are limits to the possibility of negotiating a financial program with many parties, including private banks. But they stressed that it will be crucial to avoid the appearance of a fait accompli from the Fund.

In discussing the distribution of financing gaps, banks stressed that they will strongly lobby to reduce or eliminate their contributions to general purpose financings, thus restricting their lending as far as possible to specific purposes such as trade and project financing. They will clearly seek proportionately larger contributions from the official community, including from the Fund, the World Bank, the Paris Club, and creditor government agencies. They intend to press for increased financial protection through the strengthening of cofinancing arrangements--ideally in the form of cross-default clauses with multilateral development bank loans (a concern felt particularly strongly by Japanese banks).

More generally, disbursements of bank financing would continue to be tightly linked to observance by debtor countries of policy programs agreed with the Fund and the World Bank. The linkage to conditionality in recent legal documents has been broadly in line with that of the recent past, which has been discussed in earlier staff papers. Banks have continued to include the possibility of enhanced surveillance in some agreements, for periods when countries are not using Fund resources. Banks are aware that approval by the Executive Board would be required for enhanced surveillance to become effective. With this in mind, they have limited potential periods of enhanced surveillance to approximately the consolidation period.

Banks expressed concern about net Fund repurchases by developing countries. In discussions with staff, bankers suggested that the Fund's financial involvement in the heavily indebted countries would likely need to continue on a significant scale. A number of major countries were currently carrying out adjustment policies supported by the use of Fund resources, and others were expected to do so in the future. Banks considered it important that there should not be a net withdrawal of Fund resources from countries still experiencing balance of payments difficulties, although they had been willing, in some cases, to continue to provide financing on the basis of Fund monitoring, rather than use of Fund resources. Some bankers suggested that a longer term planning horizon in the context of Fund arrangements may also be helpful, and noted that the move away from extended arrangements toward more stand-by arrangements had tended to shorten the maturities of countries' obligations to the Fund.

While these points were put forcefully by banks, most major banks acknowledged that they would not think it realistic to press these concerns to a point where several major packages were unresolved and widespread arrears emerged.

Many institutions expressed concern that the present round of financings--and possibly the pursuit of orderly solutions more generally--could be jeopardized by a sudden deterioration in the general economic situation, especially if interest rates were to rise sharply. Since such a development would be beyond the control of banks and the debtor country, banks urged that the industrial country governments should largely bear the costs resulting from a rise in interest rates, either by facilitating interest rate swaps on a large scale or by providing temporary financing through the Fund.

Banks noted that financial modalities in restructuring have evolved considerably since 1982. The 1982-83 round of restructuring typically involved one or two year consolidation periods, maturities of up to ten years, and spreads of about 2 percent. New money was largely in the form of general purpose financing. The 1984-85 round saw a selective shift to multiyear consolidation periods, with maturities of up to 14 years, and sharply reduced fees and spreads. The new money mechanism was diversified to include medium-term trade facilities, and arrangements for onlending/relending to parastatals and the private sector. In the case of Chile, debt/equity conversions were pioneered and a World Bank cofinancing guarantee was included in the package.

The 1986-87 round, following the Baker Initiative, sought to take a somewhat longer term approach to restructuring, and to respond to a sharper divergence of banks' interests. Packages have given prominence to the support of structural reforms and rebuilding of investment, with the assistance of the World Bank. Restructuring maturities have been extended to as long as 20 years and spreads have been reduced to half of 1982-83 level. Modalities for financing have been expanded progressively, including debt conversions, securitization of certain new money claims, and provision of low coupon bonds as alternative instruments (Chart 9). In some cases, techniques have also been used to avoid or reduce approaches for new financing. In Chile, the bulk of financing to be provided by commercial banks during 1987-88 is to come from a retiming of interest payments. (A fuller discussion of financing options is included in the background paper.)

Debt conversion schemes have been established in several countries (Argentina, Brazil, Chile, Costa Rica, Ecuador, Mexico and the Philippines). Such schemes are also under active consideration in a number of other countries (e.g., Guatemala, Honduras, Morocco, Nigeria, and Venezuela). During the period January 1984-June 1987, an estimated $4.5 billion in bank debt was converted under officially recognized schemes. This amount represents about 2 percent of outstanding bank debt to those debtor countries with active conversion schemes, although in some cases a substantially larger share of bank debt has been retired (e.g., in Chile, some 13 percent of the bank debt has been converted).

Explicit development of a "menu" approach to financing was featured in the package for Argentina. In addition to a trade facility, onlending, debt conversion, and cofinancing, three new features were included. Securitized new money claims (of up to $1 million per bank) with the same terms as the book claims provide an instrument that, given its bearer form and modest scale, banks view as less likely to be rescheduled than book claims. This instrument has been well received. In addition, Alternative Participation Instruments (APIs) provide a 25 year bond carrying a yield of 4 percent--substantially below the contractual interest rate on the book loans--that exempt the holder from future calls for new money. Banks viewed the pricing of this "exit" option as rather unattractive. However, APIs may make it more awkward for banks that dislike "new money," and claim not to be "free riders," to decline to participate.

Finally, a fee of 3/8 percent--to be lowered over time in two stages to zero--was offered for early participation in the new money package; bankers believed that these fees played an important part in speeding commitments. Among the other factors they cited for the relative quick mustering of this package were the concentration of claims among creditor banks that generally have been favorably disposed to the new money approach and also a greater degree of consultation with banks in determining the size and structure of the package.

Chart 9

Financing Instruments and Options in New Money Packages (NM) and Restructurings of Bank Debt (R) of Selected Developing Countries, 1983-87 1/

Country	Currency (Re)denomination	Interest Rate Options 2/	On-lending/ Re-lending	New Trade Facilities	Debt Conversions	World Bank Cofinancing/ Parallel Financing	Retiming	Securitization	Alternative Participation Instruments
1987									
Argentina	NM,R	NM,R	NM,R	NM	NM,R	NM	R	NM	R
Chile	R	R	R		R				
Philippines	R	R	R		R		R	R 4/	
Venezuela	R	R	R		R				
1986									
Brazil	R	R	R		R				
Mexico	NM,R	NM,R	NM		NM,R	NM 3/			
Nigeria	NM,R	NM,R			R				
1985									
Chile	NM,R	NM,R	NM,R		NM,R	NM 3/	R		
1984									
Argentina	NM,R	NM,R	NM	NM					
Brazil	NM,R	NM,R	NM,R						
Chile	NM	NM							
Mexico	NM	NM							
Philippines	NM,R	NM,R	NM 5/	NM					
Venezuela	R	R	R						
1983									
Argentina	NM	NM							
Brazil	NM,R	NM,R	NM,R						
Chile	NM,R	NM,R							
Mexico	NM,R	NM,R							

Sources: New financing and restructuring agreements.

1/ Classified by year of agreement in principle.
2/ Libor and domestic floating rate options or fixed rate options.
3/ Guarantees.
4/ Philippine investment notes.
5/ Revolving short-term trade facility.

Banks have also reviewed the appropriateness of the new money approach for low-income countries facing protracted debt-servicing problems. In the case of Bolivia, banks have agreed to permit direct buy-back of bank claims by the government, if adequate donor funds can be assembled. This approach reflects Bolivia's situation as a low-income country having large arrears, including interest, with loan claims being transacted at discounts of some 90 percent. The Fund temporarily approved arrears to commercial banks while negotiations on a financing package were underway, and has indicated willingness to help facilitate transfers for the buy-back. Banks indicated that some other low-income countries, albeit less dependent on bank credit than Bolivia, might also benefit from imaginative approaches to regularize their position.

Banks considered it important to encourage participation by banks with differing interests by a pragmatic expansion of the "menu" of financing options. The additional option most frequently cited by many less exposed banks would be to include limited, optional interest deferment or capitalization. Certain major banks oppose any form of interest capitalization; a more common concern is that generalized interest capitalization could entail systemic risks, and that it would adversely affect the prospects for securitizing claims since liquidity of securitized claims depends on maintaining an income stream.

There were some warnings against exaggerating the benefits that can be derived from adaptation of financing techniques. First, there are natural limits to the scope of a number of menu items, reflecting governments' needs for general purpose financing, and constraints of fiscal and monetary management. 1/ Second, some problems of bank cohesion have reflected differences in domestic tax or regulatory regimes. The scope for easing some problems through innovative instruments may be limited. However, the availability of APIs has been expanded--to $30 million per bank--for banks that wish to dispose of their entire holding (the valuation of which might be adversely affected by acceptance of APIs for some claims).

Banks' attitudes toward financing techniques may be influenced by national accounting or regulatory regimes in various ways. For example, a switch from debt to equity may entail a much higher capital weight, and restrictions may exist on the proportion of claims on a nonbank company that may be held by a bank. Treatment of interest capitalization also varies across countries. Under the U.S. accounting and regulatory system, banks may only accrue income (and classify assets as performing) if the ultimate collection of principal and interest is not in doubt and the loan is not restructured at a submarket interest rate. In Continental Europe, greater flexibility often exists. (However, this difference should not be exaggerated--capitalized or

1/ These issues were discussed in Implementation of the Debt Strategy--Current Issues (EBS/87/38, 2/20/87).

deferred interest owed to a European bank by a customer experiencing payments difficulties, would often not be accrued in practice, or would be offset by provisioning.)

Staff asked bankers about the adaptation of "menu" items to countries' prospects--for example, in the cases of countries whose situation recovers enough to seek spontaneous financing, or alternatively, countries whose economic situation worsens very seriously. Bankers pointed out that spontaneous finance had been available in modest amounts to certain countries which have been successfully pursuing appropriate policies. The examples of re-entry cited included the recovery of Turkey, and the recent agreement by a group of banks to launch a loan of $1.06 billion for Colombia (which had used concerted financing but avoided rescheduling). There are also instances of banks taking on unguaranteed portions of project loans where key industrial customers are concerned, but the main category of spontaneous financing for countries that have experienced payments difficulties appears thus far to have been short-term trade lending.

Banks were somewhat more favorably disposed toward medium-term general purpose exposure if this took the form of transferable loan certificates or privately placed securities, instruments that offer banks a potentially more liquid asset. Other financial innovations--such as defeasance--can also facilitate re-entry; but ultimately the key to regaining access to foreign savings lies in the establishment of a climate favorable to foreign inflows, including capital market liberalization and the development of equity markets.

Given the constrained availability of bank financing, attention turns naturally to other forms of longer term financing, including placing bonds with nonbank institutions. However, there has so far been very little institutional or retail demand for claims on countries that have restructured. A second source of longer term nonbank flows is equity financing. The IFC has been involved in several debt/equity swaps. It has also been engaged in exploratory work on the scope for developing closed-end funds in countries that have restructured their debt, and for possibly linking these to debt/equity conversion schemes.

With regard to countries that experience a continued and very serious deterioration in their payments situation, virtually no major banks were prepared in the present environment to contemplate generalized forgiveness of principal. Some larger banks and many smaller institutions were prepared to either postpone or capitalize interest. Some smaller banks were prepared to contemplate outright reduction in the contractual value of claims, but possibly subject to formulae that permit payments to banks to increase when, or if, the country's circumstances improve. However, other regional or local banks were demonstrably attempting to secure the benefit of full contractual interest payments without participating in financing packages.

Banks indicated that the situation of such countries might eventually have to be regularized by a negotiated reduction of claims. Some cited the proposed buy-back of debt by Bolivia in that connection. However, most banks suggested that such a resolution might in effect be preceded by considerable disorder, and would be conditioned by banks on massive creditor government support.

A common thread runs through these discussions, notwithstanding varying degrees of cooperation and optimism among banks. This was that the modalities for providing financial relief needed to evolve progressively and to reflect realistically the current situation and prospects of a country. They also needed to be increasingly tuned to the business interests and regulatory/tax regime of banks. Banks stressed that success in assembling financial packages will continue to depend crucially on the implementation of policies in creditor and debtor countries that would foster sustained growth in debtor country economies.

IV. Progress in Strengthening the System

Reviewing the overall pattern of financial flows, many bankers and officials pointed to the rapid liberalization, innovation, and growth in the money and capital markets of the industrial countries over the past two years. There was a general view that increased capital mobility and improved pricing of risk will over time result in a more effective allocation of savings. It was noted that many financial innovations could be traced back to variability in financial conditions, and in underlying macroeconomic policies, as well as to the circumvention of price and quantity regulations which full liberalization will remove. Major anxieties about the financial system could be seen as the continuing effect of credit problems that resulted from correcting past macroeconomic disturbances and not as caused by structural changes in capital markets.

At the same time, the buoyancy and openness of industrial country capital markets were contrasted with the rise of trade protectionism, and with the low level of private flows to developing countries. Concern was expressed that divergence between liberalization of goods and capital markets, and persistence of the present pattern of global capital flows, could impair the long run growth and stability of the system.

The issues addressed in these general discussions thus cut across the industrial and developing country sectors of the capital markets. Common themes include progress in managing exposure to troubled sectors; experience in handling market disturbances; and--perhaps most fundamentally--the interrelation between structural change in financial markets and the conduct of macroeconomic policy.

1. Vulnerability to debt problems

Banks' credit exposure to countries in payments difficulties has been significantly diluted since 1982, and the trend toward weaker capital ratios among banks, which emerged in the 1970s, has been reversed (Appendix Table 17). Nonetheless, in certain countries some leading institutions remain heavily exposed to sovereign risk, while the quality of domestic loan portfolios has not improved uniformly during four years of economic expansion.

Between 1982 and 1986, U.S. banks' capital relative to their exposure to developing countries nearly doubled to 96 percent (Chart 10). While other countries do not publish comparable statistics, the effect of capital increases, provisions, low or negative net lending, and recently the decline in the U.S. dollar, on average has decreased substantially their banks' exposure to countries with payments difficulties.

The provisions totaling $11 billion by nine U.S. money center banks, all but one of which are projected to make annual post tax losses in 1987, were in general well received by financial markets, especially equity markets. Market estimates indicate that several other major banks in industrial countries would experience a very substantial impact on earnings if they were to constitute reserves on this scale. Such banks' income position clearly remains vulnerable also to an interruption in interest servicing by debtor countries. For example, it has been estimated that nonpayment of interest equivalent to a 3 percentage point cut in the interest rate would lower average annual after tax earnings of the nine U.S. money center banks by some 25 percent for the period 1987-89, compared with earnings in 1985. It is notable nonetheless that the markets reacted relatively calmly to the announcement by the Brazilian authorities that they could no longer make interest payments on their medium-term external bank debt.

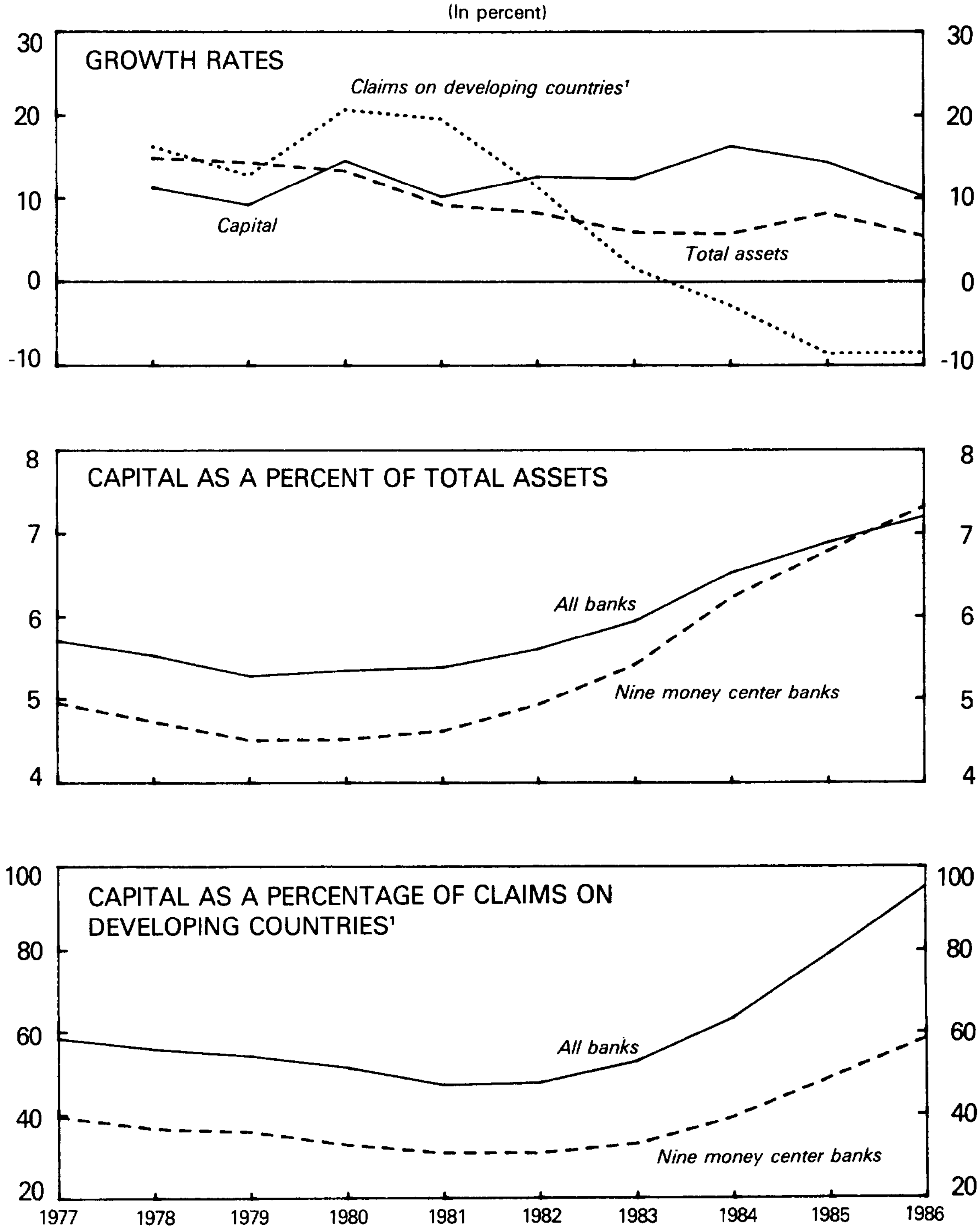
In gauging the vulnerability of the financial system, it should be borne in mind that adverse economic circumstances affecting sovereign loans could have a simultaneous, negative impact on domestic credit quality. In some countries, bank exposures to energy, real estate, shipping and elements of heavy industry remain problematic. In addition, firms in some major industrial countries have increased their leverage significantly. Ratios of corporate debt to GNP rose significantly in Germany and Japan in the period 1980-85. Corporate loan default rates are also at a 10-year high in the United States and Germany, and personal loan default rates are at a peak in the United Kingdom and Germany. In domestic, as in international business, the prevalence of floating rate lending--which effectively transforms interest rate risk into credit risk--implies that the quality of banks' loan portfolios remains vulnerable to higher interest rates.

Bank supervisors have achieved substantial progress in securing agreement internationally on an effective approach to supervising credit

CHART 10

SELECTED BALANCE SHEET DATA FOR U.S. BANKS, 1977-86

(In percent)



Sources: Federal Financial Institutions Examination Council, *Country Exposure Lending Survey*.
[1] Excluding Offshore Centers.

risk within the banking system. The issuance in March 1987 of the U.S./U.K. convergence proposals for monitoring capital adequacy, building on work of the Basle Supervisors Committee, marked a major step toward the adoption of a common supervisory framework for credit risk by most industrial countries. This framework--the risk asset ratio--applies different capital weights to various credit risks incurred by banks through both on and off balance sheet activity. In the case of note issuance facilities and swaps, many market participants thought that the actual or anticipated effect of supervisory ratios had a salutary effect on pricing.

The risk asset ratio provides a yardstick to assess the adequacy of capital held by banks of different countries, thus meeting both prudential and competitive concerns. The Fourth International Conference of Bank Supervisors, hosted by de Nederlandsche Bank in 1986, provided an important opportunity for developing countries to voice reactions concerning the previously mooted higher risk weights for sovereign loans to all developing countries--a feature not incorporated in the U.S./U.K. proposals.

As the financial services industry in industrial countries becomes more integrated, the issue of credit risk management by securities houses becomes more important. At the same time that banks are exploring the risks and opportunities in securities activities, so securities houses acquire credit risks for periods of time through expanding underwriting and dealing activities. In response, some leading securities houses have set up credit committees, although their credit appraisal and monitoring procedures are still at a relatively early stage of development.

To some degree rapid disintermediation has diminished transparency of credit exposures through various instruments and intermediaries. This may in part be a side effect of supervisory actions that have increased the capital costs of bank intermediation. Efforts have been undertaken under the aegis of the BIS to improve prudential reporting--especially of off balance sheet items--and to capture securities data more fully. Monetary authorities, including the Fund, face considerable challenges in keeping pace, in statistical work, with rapidly changing markets. Moreover, even when reporting is comprehensive, as in the interbank market, it is difficult to disentangle flows related to real economic activity from arbitrage and attempts to bypass regulatory controls.

Overall, the vulnerability of the system to a general deterioration in credit quality is difficult to evaluate precisely, but it appears considerable, especially when assessed in light of the relative maturity of the present economic expansion in the industrial economies. For the Fund, the implications of this situation reside, first, in a need to encourage economic policies that will avoid a global downturn or a renewed surge in inflation and interest rates. Second, continuing collaborative approaches among the parties to the debt strategy will remain vital to maintain a process that is orderly and allows confidence to be further rebuilt.

2. Market risk

Liberalization and innovation have tended to increase the efficiency of capital markets in several ways. Intermediation costs have been reduced by shifting intermediation to securities markets and by increased competition within the financial services industry. New instruments, such as swaps, have facilitated the arbitrage of financial conditions in different markets and over a wider spectrum of assets and maturities. Finally, hedging opportunities against fluctuations in exchange rates and interest rates have been enhanced through a variety of techniques, over a longer maturity period, and with risks potentially shared more widely among market participants.

The widespread application of new communications and computer technology to financial markets has made some of these innovations feasible and has also permitted markets to react more quickly and to process a significantly larger volume of transactions. In recent years, financial markets have thus changed considerably and price volatility--in currency, bond, or equity markets--appears at times to have increased.

Market participants have observed that new markets have been created and old markets restructured; new instruments developed; and unfamiliar lines of business developed by existing financial institutions. These changes could result, and indeed on occasion have resulted, in dislocations in markets. Such events were seen by some as part of a learning process in the markets. Most market participants were of the view that the risks associated with this process of improving the efficiency of intermediation and distribution of risks were small relative to the gains. Others worried, as did many supervisors and monetary officials, that supervision was hard pressed to keep pace with developments in the market.

The capital markets--both international and domestic--did indeed experience and withstand a number of financial shocks in 1986 and the first half of 1987. Some of these shocks were related to abrupt changes in market conditions, such as movements in interest rates and exchange rates, or were related to instruments. During the period, the U.S. dollar depreciated sharply against other major currencies; this movement was absorbed without serious foreign losses to the banking system or failures in swap instruments. Nonetheless, substantial losses related to holding of unhedged U.S. dollar-denominated assets were experienced by nonbank financial institutions in some industrial countries, especially in Japan.

Similarly, U.S. dollar interest rates rebounded sharply during early 1987; this development was sobering for the market, but did not produce significant disclosed losses. It did reveal, however, that market participants (e.g. in collateralized mortgage obligations) may find themselves less well hedged than expected or that their risk management system was less than wholly effective. The collapse of the perpetual floating rate note market was a major shock to the international bond market; the implications are still being felt. The spillover has, however, been limited to the floating rate market in general.

The robustness of the markets in the face of these shocks is a most encouraging development. However, to the extent that these shocks produced losses, those losses occurred primarily in institutions that were highly capitalized and profitable. Thus, the risk of institutional failure leading to contagion in other markets was limited. Moreover, they occurred under conditions of high liquidity in the financial system, and with other instruments available for intermediating flows.

Given these developments, and substantial progress in harmonizing approaches to credit risk, the supervisory community is turning its attention to the <u>supervision of market risks</u>. Progress in this area is seen as urgent by officials in light of the growth of the securities markets--and their close links to wholesale money markets, to which problems could spread by contagion.

The essence of regulation for securities houses--where these entities are separated from banks de jure or de facto--is to ensure that the institutions can absorb sharp market fluctuations. This approach marks asset values in the balance sheet to their market price, and tests their liquidity, frequently. Just as, for banks, the "risk asset ratio" approach has become a widely accepted technique for supervising credit risks, so assigning capital cover to market assets based on price volatility factors has become the widely recognized approach to regulating securities houses.

However, the coverage of regulation of securities houses often does not extend to monitoring the solvency of foreign--or even domestic--affiliates. Regulation has traditionally been concerned primarily with investor protection. Lender of last resort facilities normally are not available directly to such institutions. Clearly, securities house activities are closely integrated with wholesale money markets and banking activities, and the overlap in business interests between banks and securities houses continues to increase. Initial contacts have begun between securities regulators in leading financial market countries.

Bank supervision is principally oriented to the capacity of institutions to evaluate and absorb credit risk. Bank supervisory procedures capture market risk usually in an ad hoc way--except for foreign exchange positions, which have been comprehensively monitored by special reports since Herstatt. However, securitization of banks' assets is as yet only at an early stage; it is estimated that at most 2-3 percent of bank claims have been newly securitized during the recent wave of changes.

Banks' control over their liquidity positions has strengthened very substantially since 1982. Most banks have reduced their reliance on "purchased" funds from the wholesale markets and on interbank placements. The desirability of "core" funding from identified sources has become re-established, while banks have also sought to hold additional primary liquidity--liquid liabilities of the central government--in their principal funding markets. Nevertheless, the record growth of the interbank market--$750 billion over two years--raises some macroprudential concerns: banks may be funding at short term substantial increases in their securities portfolios; competition for balance sheet size between a few major banks has been intense; and affiliates in foreign centers are being used to circumvent regulatory "rigidities" in certain countries, diminishing the transparency of the system.

Monitoring of banks' liquidity by supervisors is undertaken essentially on a local market basis. Techniques are now being developed to monitor overall exposure to liquidity risk ("survival period") in foreign as well as domestic currencies. But the liquidity links within banking groups--especially those between subsidiaries with independent treasury managements--remain somewhat unexplored, and lender-of-last-resort responsibilities in this area are complex.

The mushrooming volume of financial transactions has led to greatly increased pressure on international settlement systems. The most serious problems are occurring in instruments relatively far removed from key money market settlements--in particular certain European equities. The continuing increase in central bank vigilance over settlement risks--including recent moves to limit risks in government bond and interbank settlements--appears wholly appropriate.

To the extent that intermediation activity shifts within or between countries in response to regulatory regimes, the case appears strong to harmonize more fully the regulatory--and tax--treatment of similar business in different institutions, and to reduce the existing institutional barriers between bank lending and activity in negotiable instruments. The need for coordination among different regulatory bodies, domestically as well as internationally, poses a challenge potentially greater than the challenge faced by banking supervisors in the early 1970s. While the Fund is not directly involved in this intergovernmental cooperation, it has an abiding interest in satisfactory progress. The current prominence of capital flows in the trade and payments system, while these flows appear principally responsive to macroeconomic factors, could become a potential source or transmission channel for instability in the system.

3. Macroeconomic policies

The interactions between macroeconomic policies and financial market changes are complex. In discussions, staff inquiries concentrated on the key aspects of recent experience and of policy concerns. One area of discussions related to the effect of structural changes in financial markets on the authorities' capacity to design and implement monetary policy.

The task of short-term monetary management can undoubtedly be complicated by the removal of domestic price and quantity regulations in financial markets. This is partly a transitional problem, associated with the shift from credit restraints to price allocation; with the availability of new instruments which blur the edge between money and capital market transactions; and with changes in the private sector's demand for money.

The seriousness of these complications is probably least when financial conditions and policies have been steady. A number of countries with ceilings on deposit interest rates experienced a relatively high inflation rate in the 1970s, and, during this period, their banks were confronted with repeated episodes of disintermediation. More competitive deposits were introduced because investors became more sophisticated in response to the higher inflation rates and interest rates on alternative assets. The growth of these new deposits led to serious difficulties in interpreting the behavior of various monetary aggregates. There was, over time, a shift to observing a wider range of aggregates to judge the stance of policy, and to assigning greater weight to changes in exchange or interest rates. Despite these changes, monetary authorities did not return to targeting nominal interest rates. In contrast, in "low inflation" countries, where the structure of bank liabilities did not change sharply, the reliability of monetary aggregates as guides to policy formulation has posed lesser problems for the authorities.

A second area in which deregulation has caused far reaching implications for monetary management is the removal of exchange controls. Even with flexible exchange rates, a growing foreign integration of domestic and international financial markets can alter both the timing and scope of the effects that changes in monetary policy exercise on the domestic economy and external flows. In some major countries, relaxation of exchange control led to abandonment of long-standing credit controls as external finance became a ready alternative to domestic credit.

The removal of exchange restrictions can also influence the implementation of policy through the use of monetary aggregates or interest rates. While a flexible exchange rate would allow the authorities to control the growth of the domestic monetary base, such control may be accompanied by relatively large exchange rate movements. It was frequently pointed out that gross capital movements such as occurred in Japan, the United States and the United Kingdom have become relatively large in comparison with the financial systems of many countries. Therefore, shifts in foreign portfolios can have more far-reaching implications than previously.

These recent structural changes in financial markets may also affect the conduct and international transmission of macroeconomic policies. Greater capital mobility implies that industrial countries may find it easier in the short-run to finance fiscal and current account deficits. Nevertheless, they may also find it more difficult to pursue independent monetary policies. Heightened international financial integration may cause the impact of macroeconomic policies to spread more widely and quickly through the international community.

The increased speed at which financial markets adjust, and the surge in transaction volumes in these markets, contrast with the rising protectionism and structural rigidities that hamper the ability of goods and labor markets to adjust in some industrial countries. A greater divergence in the adjustment speed between financial markets and goods markets could produce increased volatility of exchange rates and interest rates.

Most market participants and officials considered that the wide swings in financial market activity over the past decade reflected a response to--rather than a cause of--macroeconomic developments in the major industrial countries. The markets had, they considered, channelled the consequences of these changes more immediately, increasing interdependence, rather than providing an independent source of instability.

The impact of swings in macroeconomic conditions and policies has been evidenced in developments during the imbalances and inflation of the 1970s and 1980s. During the 1970s, deposit institutions channeled funds to deficit sectors in developing and industrial countries in a financing environment that favored commodities and tangible assets. Floating rate lending was developed to redistribute interest rate risk from lenders to borrowers. As a result of these developments, interest rate risk was transformed into credit risk, and credit risk proved less well diversified than expected. In the early 1980s, private flows to developing countries began declining as the perceived risks rose; at this stage official involvement increased to ease the adjustment path.

New imbalances, largely within industrial countries, grew during the early 1980s. Once again, private sector financial institutions have intermediated these imbalances. In early 1987, however, many market participants in surplus sectors changed perceptions of risks and at that time intermediation was forced (through exchange intervention) into the public sector. The scale of current imbalances was widely viewed as unsustainable by officials and bankers.

Overall, most officials and market participants held a relatively uniform view: that key macroeconomic policies in the major countries were fundamental to the stability of the system. The disparity between trade restrictions and capital liberalization could best be addressed by liberalizing goods transactions rather than restricting finance. The flow of private savings from industrial countries to developing countries would best be enhanced by stronger macroeconomic and structural policies, and thus by higher trade volumes accompanied by more stable interest rates. In a more stable environment, market discipline could more fully be relied on to protect the soundness of the financial system. Losses could then be allowed to fall where they may, including on wholesale depositors--arguably the key group whose activities may to some degree be distorted by implicit guarantees.

Bankers and officials stressed that, by contrast, the consequences of policy failures in key currency countries could be very serious, given the highly developed state of financial markets. The increasingly interdependent and complex financial superstructure was considered to be as safe as the policies followed in these major currency countries. Where the legacy of weak macroeconomic policies translates into financial market disruptions, the central remedy was seen as corrective economic policies, supported--where necessary--by additional official financing and suasion over private institutions to limit "overshooting" of market trends.

The implications of this assessment for the system--and specifically for the Fund--appear to lie principally in the crucial importance of policy coordination among the major countries. Such coordination would be seen as favoring growth both directly and by sustaining a market environment in which private sector financial intermediaries could function more effectively.

Table 1. International Lending, 1981-86

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

	1981	1982	1983	1984	1985	1986
International lending through banks and bond markets						
Total 1/, 2/						
IMF-based	433	235	205	251	326	578
BIS-based (gross) 3/	294	230	152	186	310	562
BIS-based (net of redepositing) 3/	194	144	131	152	181	245
Bond issues (net) 4/	29	49	46	62	76	85
Bank lending 1/, 2/						
IMF-based	404	186	159	189	250	493
Growth rate	20	8	6	7	9	15
BIS-based (gross)	265	181	106	124	234	477
Growth rate	20	12	7	6	11	19
BIS-based (net of redepositing)	165	95	85	90	105	160
Growth rate	20	10	8	7	8	11
International lending to industrial countries						
Total						
IMF-based	244	162	136	180	250	467
BIS-based (gross) 3/	221	180	106	147	247	448
BIS-based (net) 3/	121	94	85	113	118	131
Bond issues (net) 4/	22	39	36	51	62	72
Bank lending 1/						
IMF-based	222	123	100	129	188	395
Growth rate	18	9	7	8	12	20
BIS-based (gross)	199	141	70	96	185	376
Growth rate	15	9	4	5	9	15
BIS-based (net)	99	55	49	62	56	59
Growth rate	12	6	5	5	4	4
International lending to developing countries 5/						
Total						
IMF-based	89	54	36	17	14	-2
BIS-based 3/	55	37	28	15	20	-3
Bond issues (net) 3/, 4/	2	3	2	3	6	2
Bank lending 1/						
IMF-based	87	51	34	14	8	-4
Growth rate	22	11	7	3	1	-1
BIS-based	53	34	26	12	14	-5
Growth rate	17	10	7	2	3	-1
Memorandum item						
Total gross bond issues						
Of which:	52	76	77	110	166	225
Industrial countries	39	60	60	91	136	200
Developing countries 5/	4	5	3	5	9	5

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 the 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. Neither the IBS nor the BIS series are fully comparable over time because of expansion of coverage.

2/ Total lending includes offshore centers, international organizations, and other non-Fund members as well as industrial and developing countries.

3/ Estimates based on BIS and OECD data.

4/ Net of redemption and repurchases, and of doublecounting, i.e., bonds taken up by the reporting banks to the extent that they are included in the banking statistics as claims on nonresidents and bonds issued by the reporting banks mainly for the purpose of underpinning their international lending activity.

5/ Excludes the seven offshore centers (The Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.

Table 2. Selected Economic Indicators, 1981-87

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

	1981	1982	1983	1984	1985	1986	Estimates 1987
Total of identified current account deficits 1/	170	177	160	196	203	251	240
Industrial countries	43	52	65	123	138	167	172
Of which: seven major	24	27	51	110	123	144	153
Developing countries	127	125	95	73	65	84	68
Total of identified fiscal deficits for seven major industrial countries							
Central Government	237	306	379	365	378	428	438
General Government	166	259	287	246	261	285	305
Overall current account balances of developing countries 2/	-49	-87	-64	-34	-24	-48	-41
Reserve accumulation of developing countries (accumulation +)	-13.6	-38.9	3.7	14.8	17.3	4.6	15.4
Growth rate in value of world trade	-0.5	-6.3	-1.9	6.1	1.0	9.6	12.8
Growth rate of real GNP of industrial countries	1.4	-0.4	2.7	4.7	3.0	2.4	2.3
Inflation rate of industrial countries (GNP deflators)	8.8	7.3	5.0	4.3	3.8	3.4	2.9
Interest rates (six-month Eurodollar deposit rate)	16.7	13.6	9.9	11.3	8.6	6.8	6.5

Sources: International Monetary Fund, World Economic Outlook, April 1987: Revised Projections by the staff of the International Monetary Fund and Fund staff estimates.

1/ Sum of all current account deficits, which includes official transfers.
2/ Sum of all current account deficits and surpluses, which includes official transfers.

Table 3. Early Repayments of International Bonds, 1984-First Quarter 1987

(In billions of U.S. dollars)

	1984	1985	1986	1st Quarter 1986	1st Quarter 1987
By currency of denomination					
U.S. dollar	2.1	17.3	34.5	9.1	7.3
Deutsche mark	0.2	0.5	2.3	0.2	0.6
Swiss franc	0.4	0.3	1.5	0.1	0.6
Japanese yen	--	0.3	1.6	--	0.8
Pound sterling	0.4	0.1	0.2	--	--
Other	0.1	0.2	1.0	0.2	0.4
Total	3.2	18.7	41.1	9.6	9.7
By type of security					
Fund rate bonds	2.1	6.3	18.0	2.3	4.3
Floating rate notes	0.7	11.3	19.7	6.4	4.3
Convertibles	0.4	0.5	1.8	0.3	0.5
Floating rate certificates of deposit	--	0.6	1.6	0.6	0.6
Total	3.2	18.7	41.1	9.6	9.7
By issuer					
Australia	--	0.1	1.4	0.2	0.6
Canada	--	0.7	2.5	0.4	0.5
Denmark	--	1.0	1.8	0.3	0.3
France	0.2	4.0	6.7	2.1	1.8
Italy	0.1	--	2.0	0.9	0.2
Japan	0.3	1.1	3.1	0.8	1.0
Sweden	0.4	3.4	4.0	2.2	0.3
United Kingdom	0.3	0.8	2.5	0.4	0.4
United States	1.4	3.4	6.6	1.5	1.4
International organizations	0.0	2.3	3.6	0.1	0.4
Other	0.5	1.9	6.9	0.7	2.8
Total	3.2	18.7	41.1	9.6	9.7

Source: Organization for Economic Cooperation and Development, Financial Market Trends.

Table 4. Bank Lending and Deposit Taking, Total Cross-Border Flows, 1982-86 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985	1986
Lending to 2/	186	159	189	250	493
Industrial countries	123	100	129	188	395
Of which:					
United States	61	40	36	54	93
Japan	...	10	20	40	153
Developing countries 3/	51	34	14	8	-4
Offshore centers 4/	25	12	22	39	87
Other transactors 5/	-1	8	6	11	-7
Unallocated (nonbanks) 6/	-12	5	17	6	22
Memorandum items					
Capital importing developing countries 3/, 7/	...	30	16	9	-3
Non-oil developing countries 3/, 8/	41	27	17	7	-2
Fifteen heavily indebted countries	...	11	5	-1	-3
Deposit taking from 9/	188	187	196	275	557
Industrial countries	150	98	117	189	420
Of which:					
United States	107	35	7	22	82
Japan	...	15	12	42	114
Developing countries 3/	4	23	23	24	-3
Offshore centers 4/	25	34	19	54	130
Other transactors 5/	4	10	2	8	-7
Unallocated (nonbanks) 6/	6	22	34	--	18
Memorandum items					
Capital importing developing countries 3/, 7/	...	28	25	20	9
Non-oil developing countries 3/, 8/	17	28	23	16	17
Fifteen heavily indebted countries	...	11	14	5	-6
Change in net claims on 10/	-2	-28	-8	-25	-64
Industrial countries	-26	2	12	-1	-24
Of which:					
United States	-46	5	29	32	11
Japan	...	-5	8	-2	40
Developing countries 3/	47	11	-9	-16	-1
Offshore centers 4/	--	-22	3	-16	-43
Other transactors 5/	-5	-2	4	3	1
Unallocated (nonbanks)	-18	-16	-17	6	3
Memorandum items					
Capital importing developing countries 3/, 7/	...	2	-9	-11	-12
Non-oil developing countries 3/, 8/	24	-1	-6	-9	-19
Fifteen heavily indebted countries	...	1	-9	-6	3

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, 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 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 nonbanks 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 (the Islamic Republic of Iran, Iraq, Kuwait, the 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 5. Interbank Lending and Deposit Taking, 1982-86 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985	1986
Lending to 2/	105	115	156	211	438
Industrial countries	73	83	120	166	361
Of which:					
United States	46	39	25	33	69
Japan	...	8	22	40	148
Developing countries 3/	16	16	12	8	4
Offshore centers 4/	18	10	20	29	82
Other transactors 5/	-2	5	5	7	-10
Memorandum items					
Capital-importing developing countries 3/ 6/	...	14	13	8	5
Non-oil developing countries 3/ 7/	15	14	13	7	5
Fifteen heavily indebted countries	...	9	6	--	--
Deposit taking from 8/	125	110	149	221	469
Industrial countries	113	70	112	165	362
Of which:					
United States	81	19	14	8	56
Japan	...	15	11	40	111
Developing countries 3/	-9	6	22	3	-5
Offshore centers 4/	17	26	13	46	118
Other transactors 5/	3	8	2	7	-7
Memorandum items					
Capital-importing developing countries 3/ 6/	...	12	22	4	4
Non-oil developing countries 3/ 7/	2	12	21	1	12
Fifteen heavily indebted countries	...	1	11	-3	-7
Change in net claims on 9/	-20	5	7	-10	-31
Industrial countries	-40	13	8	1	-1
Of which:					
United States	-35	20	11	25	13
Japan	...	-7	11	-1	37
Developing countries 3/	25	10	-11	6	10
Offshore centers 4/	1	-16	6	-16	-36
Other transactors 5/	-5	-2	3	--	-3
Memorandum items					
Capital-importing developing countries 3/ 6/	...	2	-9	4	--
Non-oil developing countries 3/ 7/	13	3	-7	6	-7
Fifteen heavily indebted countries	...	8	-5	3	7
Net errors and omissions 10/	20	-5	-7	10	31

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 6. Lending to and Deposit Taking from Nonbanks, 1982-86 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985	1986
Lending to 2/	80	44	33	39	55
Industrial countries	51	16	9	22	34
Of which:					
United States	14	1	11	21	24
Japan	...	2	-3	--	5
Developing countries 3/	35	19	3	--	-9
Offshore centers 4/	7	1	2	9	5
Other transactors 5/	1	3	2	3	4
Unidentified borrowers 6/	-12	5	17	6	22
Memorandum items					
Capital-importing developing countries 3/ 7/	...	16	2	1	-7
Non-oil developing countries 3/ 8/	26	13	3	-1	-7
Fifteen heavily indebted countries	...	2	-1	-2	-4
Deposit taking from 9/	63	77	48	54	88
Industrial countries	37	28	6	24	57
Of which:					
United States	26	16	-7	14	26
Japan	...	--	1	1	3
Developing countries 3/	13	18	1	22	2
Offshore centers 4/	8	8	6	9	11
Other transactors 5/	1	2	--	1	--
Unidentified depositors 6/	6	22	34	--	18
Memorandum items					
Capital-importing developing countries 3/ 7/	...	16	3	16	5
Non-oil developing countries 3/ 8/	15	16	2	15	5
Fifteen heavily indebted countries	...	10	4	7	1
Change in net claims on 10/	17	-33	-15	-15	-33
Industrial countries	14	-11	4	-2	-23
Of which:					
United States	-12	-15	17	7	-2
Japan	...	2	-4	-1	3
Developing countries 3/	22	1	2	-22	-10
Offshore centers 4/	-1	-7	-4	1	-7
Other transactors 5/	--	1	1	2	4
Unidentified (net) 6/	-18	-16	-17	6	3
Memorandum items					
Capital-importing developing countries 3/ 7/	...	--	--	-16	-13
Non-oil developing countries 3/ 8/	12	-4	1	-15	-12
Fifteen heavily indebted countries	...	-8	-5	-9	-5

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 nonbanks 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 7. Developments in International Bond Markets, 1981-First Half 1987

	1981	1982	1983	1984	1985	1986	1st Half of 1986	1st Half of 1987
	(In billions of U.S. dollars)							
International bond issues								
By category of borrower								
Industrial countries	39	60	60	91	136	200	95	89
Developing countries	4	5	3	5	10	5	3	2
Other (including international organizations)	8	11	14	13	20	20	11	11
Total international bonds	52	76	77	110	166	225	109	102
Amortization	16	18	18	20	35	64	28	31
Net issues 1/	36	58	59	90	131	161	81	71
Bond purchases by banks	7	9	13	28	55	76	32	...
Net issues less								
Bond purchases by banks	29	49	46	62	76	85	49	...
Of which:								
Industrial countries	22	39	36	51	62	72	42	...
Developing countries	2	3	2	3	6	2	1	...
	(In percent)							
By currency of denomination								
U.S. dollar	63	64	57	64	61	55	52	33
Deutsche mark	5	7	9	6	7	8	9	9
Swiss franc	16	15	18	12	9	10	10	10
Japanese yen	6	5	5	6	8	10	10	19
Other	10	9	11	12	15	17	19	29
	(In percent per annum)							
Interest rate developments								
Eurodollar deposits 2/	13.3	9.5	10.1	9.0	8.0	6.3	7.0	6.6 4/
Dollar Eurobonds 3/	14.9	13.4	12.5	12.1	10.6	8.6	8.9	8.4 4/
Deutsche mark international bonds 3/	9.2	8.2	8.4	7.4	6.9	6.4	6.8	6.6 4/

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/ Gross issues less scheduled repayments and early redemption.
2/ Three-month deposits.
3/ Bonds with remaining maturity of 7-15 years.
4/ January-May average.

Table 8. Market for Fixed Rate Bonds, 1983-First Quarter 1987

(In billions of U.S. dollars)

	1983	1984	1985	1986	1st Quarter 1986	1st Quarter 1987
Borrowers, total	49.4	58.4	92.7	147.2	38.2	48.6
Industrial countries	37.0	45.9	74.9	129.3	32.5	42.6
Of which:						
Australia	2.1	2.5	5.0	5.8	2.3	1.6
Austria	1.3	1.7	1.9	3.0	1.0	1.6
Canada	6.2	5.2	7.3	13.2	3.8	2.4
Denmark	0.6	2.1	2.2	7.4	0.3	2.7
France	3.2	2.8	4.7	9.2	1.9	3.4
Germany, Fed. Rep. of	1.8	0.7	1.7	7.4	0.9	4.6
Italy	0.9	0.2	0.8	2.3	0.6	0.6
Japan	6.1	6.5	11.3	19.4	3.2	6.8
Netherlands	0.9	1.0	1.3	2.8	1.0	1.2
New Zealand	0.5	1.4	1.4	2.9	0.6	0.9
Norway	0.6	0.7	1.4	4.3	0.5	2.6
Sweden	1.6	2.1	3.8	5.7	2.5	1.8
United Kingdom	1.7	1.1	2.2	5.7	1.4	3.2
United States	5.9	14.6	26.7	29.7	9.5	5.7
Developing countries	1.1	1.3	3.2	2.7	0.9	0.6
Other, including international organizations	11.3	11.1	14.6	15.2	4.8	5.4
Currency distribution, total						
U.S. dollar	21.4	26.9	43.4	68.1	17.9	14.3
Japanese yen	4.1	6.0	11.8	22.5	6.9	8.4
Swiss franc	9.8	8.7	10.3	16.5	4.5	4.6
Deutsche mark	6.3	5.8	6.6	11.6	2.5	6.6
ECU	2.1	2.5	5.9	6.1	1.0	3.4
Pound sterling	2.2	3.4	3.1	4.9	1.7	4.4
Australian dollar	0.2	6.0	3.0	3.0	1.1	2.4
Canadian dollar	1.1	2.2	2.8	5.2	0.8	2.1
Netherlands guilder	1.6	1.8	1.6	2.6	0.6	0.7
Other	0.6	0.8	4.2	6.7	1.2	1.7

Source: Organization for Economic Cooperation and Development, Financial Market Trends.

Table 9. Market for Floating Rate Issues, 1983-First Quarter 1987

(In billions of U.S. dollars)

	1983	1984	1985	1986	1st Quarter 1986	1st Quarter 1987
Borrowers, total	19.5	58.1	58.4	50.7	8.9	3.0
Industrial countries	15.6	34.6	48.1	47.2	7.6	2.4
Of which:						
Belgium	0.9	1.6	1.8	1.6	0.5	--
Canada	0.3	0.8	2.1	3.0	0.2	--
Denmark	1.8	1.7	0.7	1.2	--	--
France	4.1	5.4	6.4	4.0	0.6	--
Italy	0.5	3.5	4.2	2.0	0.4	--
Japan	2.5	2.9	1.9	2.0	0.1	0.3
Sweden	2.6	4.1	2.2	0.1	--	--
United Kingdom	0.2	3.7	12.1	12.4	1.8	0.3
United States	0.3	5.5	10.5	10.7	2.3	1.3
Developing countries	1.8	3.3	7.0	2.0	0.7	0.1
Other, including international organizations	2.0	0.3	3.3	1.5	0.6	0.5
Currency distribution, total	19.5	38.1	58.4	50.7	8.9	3.0
U.S. dollar	18.5	35.1	49.9	40.9	6.0	2.2
Pound sterling	0.7	2.0	3.3	5.5	1.4	0.2
Deutsche mark	--	--	3.2	1.6	0.6	0.2
ECU	--	0.5	1.1	0.8	0.5	--
Other	0.3	0.6	0.9	1.9	0.4	0.4

Sources: Organization for Economic Cooperation and Development, Financial Market Trends.

Table 10. Market for Equity-Related Bonds, 1983-First Quarter 1987

(In billions of U.S. dollars)

	1983	1984	1985	1986	1st Quarter 1986	1st Quarter 1987
Borrowers, total	8.0	10.9	11.5	22.3	4.6	5.1
Japan	4.9	7.6	6.8	11.8	2.3	2.0
United States	1.0	1.9	2.2	2.9	0.6	1.0
United Kingdom	0.1	0.3	0.7	1.3	--	0.7
Germany, Fed. Rep. of	0.7	0.3	1.0	1.7	0.7	--
Switzerland	0.6	0.2	0.2	0.7	0.4	0.3
Other OECD countries	0.7	0.6	0.6	3.9	0.6	1.1
Currency distribution, total	8.0	10.9	11.5	22.3	4.6	5.1
U.S. dollar	3.9	5.5	5.3	11.7	2.7	2.3
Swiss franc	3.6	4.2	4.1	6.7	1.0	1.4
Deutsche mark	0.4	0.9	1.2	2.8	0.8	0.6
Other	0.1	0.3	0.8	1.1	0.1	0.8

Source: Organization for Economic Cooperation and Development, Financial Market Trends.

Table 11. Bank Lending to Developing Countries, 1983-86 1/ 2/

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

	1983	1984	1985	1986
Developing countries	34.3	14.4	7.7	-4.2
Growth rate	7	3	1	-1
Africa	5.4	-0.3	1.4	-2.5
Of which:				
Algeria	0.2	0.1	1.9	0.6
Cote d'Ivoire	-0.1	-0.3	0.1	--
Morocco	0.3	0.1	0.1	--
Nigeria	1.3	-0.4	-0.7	-0.3
South Africa	3.0	-1.4	-0.3	-2.1
Asia	9.0	8.1	6.3	4.7
Of which:				
China	0.8	1.3	4.8	0.7
India	0.9	0.1	1.7	0.3
Indonesia	2.7	0.7	0.1	0.6
Korea	2.0	3.5	2.2	-2.4
Malaysia	1.9	1.4	-1.4	-0.5
Philippines	-1.3	0.1	-0.5	-0.1
Europe	1.3	2.2	1.8	-0.4
Of which:				
Greece	1.3	1.8	1.6	0.4
Hungary	0.9	0.2	2.1	2.0
Turkey	0.5	0.9	0.5	1.5
Yugoslavia	--	0.2	0.2	-0.9
Middle East	3.6	-1.0	-2.3	-2.4
Of which:				
Egypt	-0.7	0.6	-0.3	-0.1
Israel	-0.3	-0.7	-0.8	-1.1
Western Hemisphere	15.0	5.5	0.4	-3.6
Of which:				
Argentina	2.3	-0.2	0.5	1.2
Brazil	5.2	5.2	-2.9	--
Chile	0.3	1.2	0.2	-0.4
Colombia	0.6	0.1	--	0.4
Ecuador	0.2	-0.1	0.2	0.1
Mexico	2.8	1.3	1.4	-1.5
Venezuela	-1.2	-2.2	0.5	-1.4
Memorandum items				
Fifteen heavily indebted countries	11.3	4.9	-1.4	-3.5
Countries experiencing debt servicing problems	8.3	3.1	-0.5	-11.0
Gross concerted lending disbursements 3/	13.1	10.4	5.4	3.1
Total, BIS-based	26.4	11.6	14.4	-5.4
Growth rate	7	2	3	-1
Gross bond issues	3.1	5.0	9.1	4.6

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 inter-bank 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 the 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. Neither the IBS series nor the BIS series are fully comparable over time because of expansion of coverage.

2/ Excluding the seven offshore centers (The Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore).

3/ Excluding bridge loans.

Table 12. Debt Conversions, 1984-First Half 1987 1/

(In millions of U.S. dollars)

	1984	1985	1986	1987 Jan.-June
Argentina	31	469 2/	--	--
Brazil	731	537	176	67 3/
Chile	--	371 4/	969 4/	427 5/
Costa Rica	--	--	15	47
Ecuador	--	--	--	15 5/
Mexico	--	--	412	203 6/
Philippines	--	--	15	56
Total	762	1,377	1,587	815

Sources: Central Bank of Argentina; Central Bank of Brazil; Central Bank of Chile; Mexico, Ministry of Finance; Central Bank of Philippines; and Fund staff estimates.

1/ Face value of debt converted under officially recognized schemes.
2/ The annual breakdown of conversions is estimated.
3/ January-April 1987.
4/ Of the total conversions 1985-86, an estimated $152 million was capitalized under the Foreign Investment Law (DL 600); $229 million was converted into equity with remittance rights under Chapter XIX; $526 million was converted without remittance rights under Chapter XVIII, and the remainder involved portfolio swaps and write-offs agreed between foreign creditors and domestic debtors mainly in the private sector.
5/ January-March 1987.
6/ As of March 31, 1987, 107 conversions with a face value of $1,514 million had been approved.

Table 13. Long-Term Bank Credit Commitments to Developing Countries, 1981-May 1987

(In billions of U.S. dollars)

	1981	1982	1983	1984 1/	1985 2/	1986 3/	Jan.-May 1986	Jan.-May 1987 4/
Developing countries 5/	44.4	42.4	34.0	31.3	17.0	24.8	6.5	7.1
Spontaneous lending	44.4	42.4	19.8	14.8	14.8	16.7	6.5	5.1
Concerted lending 6/	...	...	14.2	16.5	2.2	8.1	--	2.0
Capital-importing 5/	43.3	40.4	31.7	30.2	15.4	23.3	5.8	7.1
Spontaneous lending	43.3	40.4	17.5	13.7	13.2	15.2	5.8	5.1
Concerted lending 6/	...	...	14.2	16.5	2.2	8.1	--	2.0
Africa	4.1	2.7	2.7	0.6	1.3	1.8	0.5	0.3
Spontaneous lending	4.1	2.7	2.7	0.5	1.3	1.4	0.5	0.3
Concerted lending 6/	...	...	--	0.1	--	0.4	--	--
Asia	10.0	11.1	9.4	9.4	7.0	8.0	3.7	3.1
Spontaneous lending	10.0	11.1	9.4	8.5	7.0	8.0	3.7	3.1
Concerted lending 6/	...	...	--	0.9	--	--	--	--
Europe	4.7	3.7	3.5	3.7	4.4	5.2	1.6	1.5
Spontaneous lending	4.7	3.7	2.9	3.7	4.4	5.2	1.6	1.5
Concerted lending 6/	...	...	0.6	--	--	--	--	--
Middle East	0.2	0.4	0.6	0.4	0.3	0.1	--	0.2
Western Hemisphere	24.3	22.5	15.5	16.1	2.3	8.3	--	2.1
Spontaneous lending	24.3	22.5	1.9	0.6	0.1	0.6	--	0.1
Concerted lending 6/	...	...	13.6 7/	15.5	2.2	7.7	--	2.0
Memorandum Items:								
Offshore banking centers	3.7	2.2	1.2	0.9	0.6	1.1	0.2	0.2
Developing countries including offshore banking centers	48.1	44.6	35.2	32.2	17.6	25.9	6.7	7.3

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, Cote d'Ivoire, Ecuador and the Philippines.
2/ Includes \$0.1 billion revolving trade facility for Costa Rica.
3/ Includes agreements in principle with Congo, Mexico, and Nigeria.
4/ Includes agreement in principle with Argentina.
5/ Excludes offshore banking centers.
6/ Concerted lending refers to bank credit commitments obtained during 1983-87 and coordinated by a bank advisory committee (i.e., Argentina, Brazil, Chile, Colombia, Congo, Cote d'Ivoire, Ecuador, Mexico, Nigeria, Panama, Peru, the Philippines, Uruguay, and Yugoslavia).
7/ Excludes the extension of a bridging loan of \$1.3 billion to Argentina, and \$0.2 billion revolving trade facility to Costa Rica.

Table 14. Terms of Long-Term
Bank Credit Commitments, 1981-First Quarter 1987 1/

(In percent, unless otherwise indicated)

	1981	1982	1983	1984 2/	1985 3/	1986 4/	1st Qtr. 1987 5/
Six-month Eurodollar interbank rate (average)	16.72	13.60	9.93	11.29	8.64	6.85	6.36
U.S. prime rate (average)	18.87	14.86	10.79	12.04	9.93	8.33	7.50
Average maturity (in years/months)	7/8	7/7	7/3	7/9	7/8	7/0	6/6
OECD countries	7/8	8/3	7/8	7/4	7/3	6/8	5/5
Centrally planned economies	5/7	4/9	4/5	5/11	7/5	7/5	7/6
Oil exporting countries	7/9	6/0	7/2	7/7	6/11	7/9	10/5
Other developing countries	7/9	7/0	7/0	8/11	9/1	8/2	8/7
Average spread	0.80	0.77	1.15	0.93	0.60	0.40	0.35
OECD countries	0.58	0.56	0.65	0.55	0.41	0.36	0.28
Centrally planned economies	0.62	1.03	1.18	0.88	0.55	0.26	0.23
Oil exporting countries	0.79	0.94	0.85	0.76	0.72	0.46	0.63
Other developing countries	1.04	1.14	1.70	1.44	0.99	0.67	0.60

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

1/ OECD country classification.
2/ Does not include terms of agreements in principle with Argentina and the Philippines.
3/ Does not include terms of agreement in principle with Chile and Colombia.
4/ Does not include terms of agreement in principle with Mexico.
5/ Does not include terms of agreement in principle with Argentina.

Table 15. International Bond Issues by Developing Countries, 1982-First Half 1987 1/

(In millions of U.S. dollars)

	1982	1983	1984	1985	1986	1st half of 1986	1st half of 1987
Developing countries 2/	4,498.7	3,121.4	4,978.0	9,127.6	4,623.9	3,226.3	1,928.4
Capital importing developing countries 2/	4,388.7	3,121.4	4,703.0	9,127.6	4,623.9	3,226.3	1,928.4
Africa	347.3	592.5	1,013.9	1,298.2	125.6	90.1	—
Of which:							
Algeria	—	—	—	500.0	125.6	90.1	—
South Africa	314.1	532.5	1,013.9	777.9	—	—	—
Asia	1,799.7	2,171.1	2,951.0	5,916.7	2,803.9	2,259.2	857.4
Of which:							
China	44.5	20.5	81.7	959.9	1,383.4	1,051.1	417.2
India	185.0	60.0	297.6	372.8	293.2	248.8	197.3
Indonesia	363.1	365.7	50.0	—	300.0	300.0	—
Korea	141.5	546.8	1,056.0	1,700.1	733.0	638.0	77.3
Malaysia	816.8	884.6	1,141.2	2,001.9	43.0	—	165.6
Philippines	30.0	—	—	—	—	—	—
Thailand	62.5	253.5	283.3	861.7	—	—	—
Europe	233.3	117.8	630.7	1,638.6	1,033.1	747.0	952.3
Of which:							
Greece	50.0	41.6	200.8	744.7	204.9	204.9	276.1
Hungary	—	—	40.5	447.1	290.5	163.0	272.2
Portugal	183.3	76.2	389.4	347.4	432.5	273.9	273.6
Turkey	—	—	—	99.4	105.2	105.2	130.4
Middle East	175.0	175.0	—	72.0	—	—	20.0
Of which:							
Egypt	65.0	40.0	—	50.0	—	—	—
Israel	110.0	135.0	—	22.0	—	—	20.0
Western Hemisphere	1,833.4	65.0	107.4	202.1	661.3	130.0	98.7
Of which:							
Argentina	—	—	—	—	—	—	—
Brazil	100.9	—	—	—	169.2	—	—
Chile	—	—	—	—	—	—	—
Colombia	35.0	15.0	—	—	39.0	—	50.0
Mexico	1,602.5	—	—	49.0	313.3	50.0	—
Peru	—	—	—	—	—	—	—
Venezuela	35.0	—	—	—	—	—	—
Memorandum items:							
Offshore banking centers	196.7	153.8	285.6	1,209.4	848.2	50.6	217.0
Developing countries, including offshore banking centers	4,695.4	3,275.2	5,263.6	10,337.0	5,472.1	3,276.9	2,145.4

Source: Organization for Economic Cooperation and Development, Financial Statistics Monthly.
1/ Foreign bonds and Eurobonds.
2/ Excludes offshore banking centers.

Table 16. Change in Consolidated Bank Claims on Developing Countries, 1982-86 1/

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

	1982		1983		1984		1985		1986	
	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	Billions of U.S. dollars	Growth rate
Developing countries 2/										
U.S. claims data	11.1	7.8	5.8	3.8	-3.8	-2.4	-13.3	-8.5	-13.5	-9.4
U.K. claims data	6.0	10.2	2.1	3.2	-1.2	-1.8	-0.4	-0.6	0.6	0.9
Capital-importing developing countries 2/										
U.S. claims data	11.1	8.1	5.3	3.6	-3.1	-2.0	-12.0	-8.0	-12.6	-9.1
U.K. claims data	5.9	10.7	1.7	2.8	-0.5	-0.8	-0.5	-0.8	0.8	1.3
Africa										
U.S. claims data	1.3	12.4	1.0	8.5	-0.8	-6.0	-2.8	-22.4	-2.0	-20.1
U.K. claims data	2.9	31.1	0.5	4.1	-0.2	-2.0	-0.8	-6.4	--	0.1
Asia										
U.S. claims data	3.8	14.2	1.4	4.5	-3.0	-9.5	-3.4	-11.9	-4.8	-19.0
U.K. claims data	1.4	16.5	0.4	3.6	-0.3	-3.0	0.2	2.3	-0.1	-1.1
Indonesia										
U.S. claims data	0.6	24.2	0.6	19.9	-0.2	-5.0	-0.6	-18.8	-0.6	-21.6
U.K. claims data	0.5	63.6	0.3	26.0	--	2.1	-0.1	-3.0	--	-1.0
Korea										
U.S. claims data	2.1	24.1	0.5	4.1	-1.5	-13.3	-0.8	-7.9	-3.2	-34.6
U.K. claims data	0.3	10.8	-0.2	-7.4	-0.1	-2.5	-0.1	-2.0	-0.3	-9.8
Philippines										
U.S. claims data	0.4	6.9	0.3	5.5	-0.6	-10.0	--	-0.7	-0.3	-5.8
U.K. claims data	0.2	11.7	0.1	4.2	-0.2	-9.6	-0.1	-8.7	0.1	6.0
Europe										
U.S. claims data	-1.2	-10.0	0.4	4.1	-0.7	-6.5	-0.6	-5.8	-1.7	-17.6
U.K. claims data	-0.5	-5.7	-0.1	-0.3	-0.5	-6.0	0.2	2.4	--	0.2
Middle East										
U.S. claims data	0.3	8.1	0.3	8.5	-0.4	-9.0	-0.7	-18.8	-0.6	-20.3
U.K. claims data	0.5	32.0	-0.2	-11.2	-0.2	-13.3	--	2.0	-0.1	-6.2
Western Hemisphere										
U.S. claims data	6.9	8.2	2.1	2.3	1.8	1.9	-4.5	-4.7	-3.5	-3.9
U.K. claims data	1.6	6.1	1.1	3.9	0.8	2.8	-0.1	-0.5	1.0	3.2
Argentina										
U.S. claims data	-0.2	-2.0	0.3	3.3	-0.5	-6.3	0.4	5.5	0.1	1.4
U.K. claims data	-0.3	-7.8	0.1	2.8	-0.1	-1.3	0.3	8.3	0.4	11.8
Brazil										
U.S. claims data	3.6	21.5	0.2	1.1	3.2	15.6	-1.1	-4.5	-0.4	-1.7
U.K. claims data	1.2	18.2	0.7	8.5	0.7	8.5	-0.2	-2.2	0.4	4.1
Mexico										
U.S. claims data	2.9	13.4	2.0	8.0	0.2	0.7	-1.6	-6.0	-1.3	-5.1
U.K. claims data	0.2	3.1	0.3	3.8	0.1	1.1	-0.1	-0.9	--	0.1
Venezuela										
U.S. claims data	1.1	10.5	-0.3	-2.8	-0.4	-4.0	-0.7	-6.7	-1.0	-9.7
U.K. claims data	-0.1	-4.3	-0.2	-5.4	-0.1	-4.2	-0.1	-2.9	--	-1.8

Sources: 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; owing to rounding, components may not add.

2/ Excludes offshore banking centers.

Table 17. Capital-Asset Ratios of Banks in Selected Industrial Countries, 1978-86 1/

(In percent)

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Canada 2/	3.3	3.2	3.0	3.5 3/	3.7	4.1	4.4	4.6	5.0
France 4/	2.3	2.6	2.4	2.2	2.1	2.0	1.9	2.2	2.6
Germany,									
Federal Republic of 5/	3.3	3.3	3.3	3.3	3.3	3.3	3.4	3.5	3.6
Japan 6/	5.1	5.1	5.3	5.3	5.0	5.2	5.2	4.8	4.8
Luxembourg 7/	...	...	3.5	3.5	3.5	3.6	3.8	4.0	4.1
Netherlands 8/	3.9	4.3	4.2	4.3	4.6	4.7	4.8	5.0	5.2
Switzerland 9/									
Largest 5 banks	7.8	7.6	7.6	7.4	7.3	7.1	7.1	7.8	7.8
All banks	7.8	7.6	7.6	7.5	7.5	7.3	7.4	7.8	7.9
United Kingdom									
Largest 4 banks 10/	7.5	7.2	6.9	6.5	6.4	6.7	6.3	7.9	8.4
All banks 11/	5.2	5.1	5.0	4.5	4.1	4.4	4.5	5.5	5.4
United States									
9 money center banks 12/	4.7	4.5	4.5	4.6	4.9	5.4	6.2	6.8	7.3
Next 15 banks 12/	5.4	5.4	5.5	5.2	5.3	5.7	6.6	7.2	7.5
All country reporting banks 12/, 13/	5.5	5.3	5.4	5.4	5.6	5.9	6.5	6.9	7.2

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

1/ Aggregate figures such as the ones in this table must be interpreted with caution, due to differences 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 exclude cooperative and mutual banks. This ratio is not the official one (ratio of risk coverage), which includes loan capital and subordinate loans in the numerator and balances the denominator with regard the quality of the assets, and which provides the groundwork for the control of the banking activities by the Commission Bancaire. (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 1986 would show a ratio of 7.7 percent. Inclusion of current-year profits in banks' capital resources would result in a weighted average of 4.3 percent for 1986. Provisions for country risks, which are excluded from capital resources, have been considerably increased in the last year. The 1986 level of provision represents almost five times the level of 1982.

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 total assets (Swiss National Bank, Monthly Report).

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 (including 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 of the Federal Financial Institutions Examination Council.