SM/85/267

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September 27, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject: International Capital Markets - Developments and Prospects, 1985

There is attached for consideration by the Executive Directors a paper on developments and prospects in international capital markets, which will be brought to the agenda for discussion on a date to be announced. A supplement containing background material will be issued shortly.

As in previous years it is planned that an Occasional Paper be prepared based upon the staff report and the background paper. A revised text for this purpose will be circulated to Executive Directors after the Executive Board discussion. That revised text will reflect Executive Director's 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, 1985

Prepared by the Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by C. David Finch

September 26, 1985

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I. Introduction

The last review of recent trends in international capital markets by the Executive Board was the discussion of "International Capital Markets--Developments and Prospects, 1984" (SM/84/134, 6/13/84; EBM/84/105, 7/13/84). Aspects of this general subject were, however, discussed in the context of several subsequent Executive Board papers. Developments in bank debt restructuring and bank lending to developing countries were reviewed in "Developing Countries' External Indebtedness to Commercial Banks" (SM/85/61, 2/20/85 and Supplement 1, 3/6/85; EBM/85/46, 3/20/85). Issues raised by enhanced surveillance were examined by the Executive Board in connection with "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" (EBS/85/173, 7/23/85; EBM/85/129, 8/30/85).

The present staff report includes, in Section II, a description of recent developments in capital markets. 1/ Section III discusses two aspects of current changes in financial markets--developments in the debt situation and recent trends in liberalization and innovation. Section IV identifies major policy issues relating to the prospects for financial market flows. As in past years, this paper will be accompanied by a background paper which provides additional factual information on capital market trends, developments in bank debt restructuring, and changes in supervision.

1/ A staff team comprising Messrs. C.M. Watson (ETR), D. Mathieson (RES), G.R. Kincaid and E.R.J. Kalter (both ETR), and Ms. V. Pinckney (Secretary, ETR), held informal discussions with bankers and with the staff of monetary and bank supervisory authorities and international organizations (BIS and OECD) in Amsterdam, Basle, Berlin, Berne, Brussels, Frankfurt, London, Luxembourg, Paris, and Zurich. Ms. Eken (Office in Europe) participated in the meetings in Paris and Brussels. Similar discussions were held in New York, Washington (including the World Bank and the Institute of International Finance), Ottawa and Toronto, Singapore, and Tokyo (including the Japan Center for International Finance). Other staff members who participated in some of the meetings were Messrs. C.V.A. Collyns and L.E. DeMilner (both WHD). These meetings took place at various times during June-September 1985. Staff of the Bureau of Statistics, particularly Messrs. P. Joyce and C. Briancon, developed and compiled the data based on the Fund's International Banking Statistics. Mr. K. Regling (ETR) also contributed to the paper. It should be noted that the term "country" used in this document does not in all instances refer to a territorial entity which is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.

II. Recent Trends in International Financial Markets

After declining during 1982-83, total net lending through international capital markets rose by $63 billion to $247 billion in 1984 (Table 1). According to the Fund's International Banking Statistics (IBS), cross-border bank lending increased in 1984 to $187 billion, 1/ about the same level as in 1982. This growth in bank lending reflected activity in the interbank market of industrial countries, as new lending to nonbanks in industrial countries and to developing countries experienced a further decline. Net issues of international bonds 2/ rose to a record level of $60 billion in 1984. These trends in bank lending and the bond market continued in early 1985.

This section discusses the general macroeconomic background to these developments, and reviews key features of bank and bond market activity.

1. Economic and financial environment

Total identified current account deficits expanded sharply in 1984, from $150 billion to $186 billion, despite a decline of $22 billion in the deficits of developing countries. Total identified deficits are estimated to rise further to $223 billion in 1985. The growth and pattern of international financial flows in 1984-85 has primarily reflected an expansion of financing needs in industrial countries.

The current account deficits of the industrial countries rose from $40 billion in 1982 to $108 billion in 1984, with the sharp increase in the U.S. current account deficit (from $3 billion in 1982 to $93 billion in 1984) more than accounting for this rise. For 1985, the identified current account deficits of industrial countries are estimated to rise further to $141 billion; the U.S. current account deficit is expected to increase to $123 billion. The distribution of current account imbalances has been one key factor in the shift of international financing flows toward securities market transactions, by contrast with the rapid growth in bank intermediation that occurred prior to 1982.

The current pattern of investment and savings has been characterized by increased deficits among borrowers whose high credit standing afforded them considerable access to securities markets, and increased surpluses among savers, which invested directly in such instruments. The financing requirements of the U.S. fiscal deficit were partly satisfied by large foreign purchases of U.S. Government securities. Nonfinancial companies in the United States borrowed more heavily

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1/ Data on banking activity in this section have been adjusted to exclude changes attributed to exchange rate movements.
2/ Net of redemptions and purchases of bonds by banks.

Table 1. International Lending and Selected Economic Indicators, 1979-1985

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

	1979	1980	1981	1982	1983	1984	1985 Estimates
International lending through banks and bond markets							
Total 1/							
IMF based	370	414	434	236	184	247	...
BIS based	148	179	195	145	130	153	...
Bond issues (net) 2/	23	19	30	50	45	60	...
Bank lending 1/							
IMF based	347	395	404	186	139	187	...
(growth rate)	(27)	(24)	(20)	(8)	(5)	(7)	(...)
BIS based (net of redepositing)	125	160	165	95	85	93	...
(growth rate)	(23)	(24)	(20)	(10)	(8)	(8)	(...)
International lending to developing countries 3/							
Bond issues 4/	3	2	4	5	3	5	...
Bank lending 1/							
IMF based	59	85	87	51	38	15	...
(growth rate)	(23)	(27)	(22)	(11)	(7)	(3)	(...)
BIS based	48	55	33	33	26	8	...
(growth rate)	(23)	(22)	(17)	(9)	(7)	(2)	(...)
World economic developments							
Total of identified current account deficits 5/	98	151	175	172	150	186	223
Industrial countries	29	59	41	40	50	108	141
of which:							
Seven largest	(12)	(31)	(16)	(17)	(37)	(96)	(130)
Developing countries	69	92	134	133	100	78	82
Overall current account balance of capital importing developing countries	-61	-77	-113	-104	-60	-38	-44
Reserve accumulation of capital importing developing countries 6/ (accumulation +)	22	19	-3	-18	9	18	4
Growth rate in value of world trade	26.3	21.5	-0.6	-6.3	-2.3	6.4	1.8
Growth rate of real GNP of industrial countries	3.5	2.0	1.7	0.4	2.5	4.5	2.8
Inflation rate of industrial countries ((GNP deflators)	7.9	9.1	8.7	7.2	4.8	4.1	3.2
Interest rates (six-month Euro-dollar deposit rate)	11.9	13.9	16.7	13.6	9.9	11.3	8.5

Sources: Bank for International Settlements; Organization for Economic Cooperation and Development; International Monetary Fund, International Financial Statistics; "World Economic Outlook - General Survey" (EBS/85/201, 8/26/85); 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 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 coverage of the series. The BIS data are derived from geographical analyses provided by banks in the BIS reporting area. The IMF data derive cross-border interbank positions from the regular money and banking data supplied by member countries, while the IMF analysis of transactions with nonbanks is based on data from geographical breakdowns provided by the BIS reporting countries and additional banking centers. Both IBS and BIS series are not fully comparable over time due to expanding coverage.

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

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

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

5/ Goods, services, and private transfers.

6/ Based on balance-of-payments definitions.

in international capital markets. In Japan and Europe, nonfinancial corporations have utilized higher profits associated with economic recovery to strengthen their balance sheets by rebuilding financial assets and reducing their net indebtedness to banks.

The group of capital-importing developing countries engaged in strong adjustment efforts associated with tight external financing constraints. Their current account deficit declined sharply from $60 billion in 1983 to $38 billion in 1984; according to latest staff estimates, their current account deficits would rise to $44 billion in 1985. Nondebt-creating flows plus net disbursement from official sources averaged about $51 billion during 1984-85. As a result, the current account deficits of these countries were more than covered by financing from sources other than international capital markets.

Current account imbalances of many developing country groups were reduced to levels not recorded since the 1960s. The associated drop in foreign capital flows has been most evident for those developing countries which have relied on external borrowing from commercial banks (i.e., market borrowers) or its principal subgroup (i.e., major borrowers). The current account deficits of the market borrowers, which averaged 3 percent of gross domestic product (GDP) during 1973-82, declined to less than 1 percent in 1984 or the lowest ratio since 1967. In contrast, the official borrowers continued to run current account deficits equivalent to approximately 6 percent of GDP in 1984--close to the average level of their deficits during 1973-82.

2. Banking activity

International banks' overall cross-border lending 1/ grew by 7 percent in 1984; such lending reached $187 billion--well above total lending of $139 billion during 1983 (Chart 1 and Table 2). Bank lending to industrial countries rose to $114 billion during 1984 from $92 billion during 1983 after having declined during the previous two years. With relatively limited lending opportunities to nonbanks in industrial countries, increased bank lending was more than accounted for by greater interbank lending, which jumped to $106 billion during 1984 from $77 billion during 1983 (Appendix Table I).

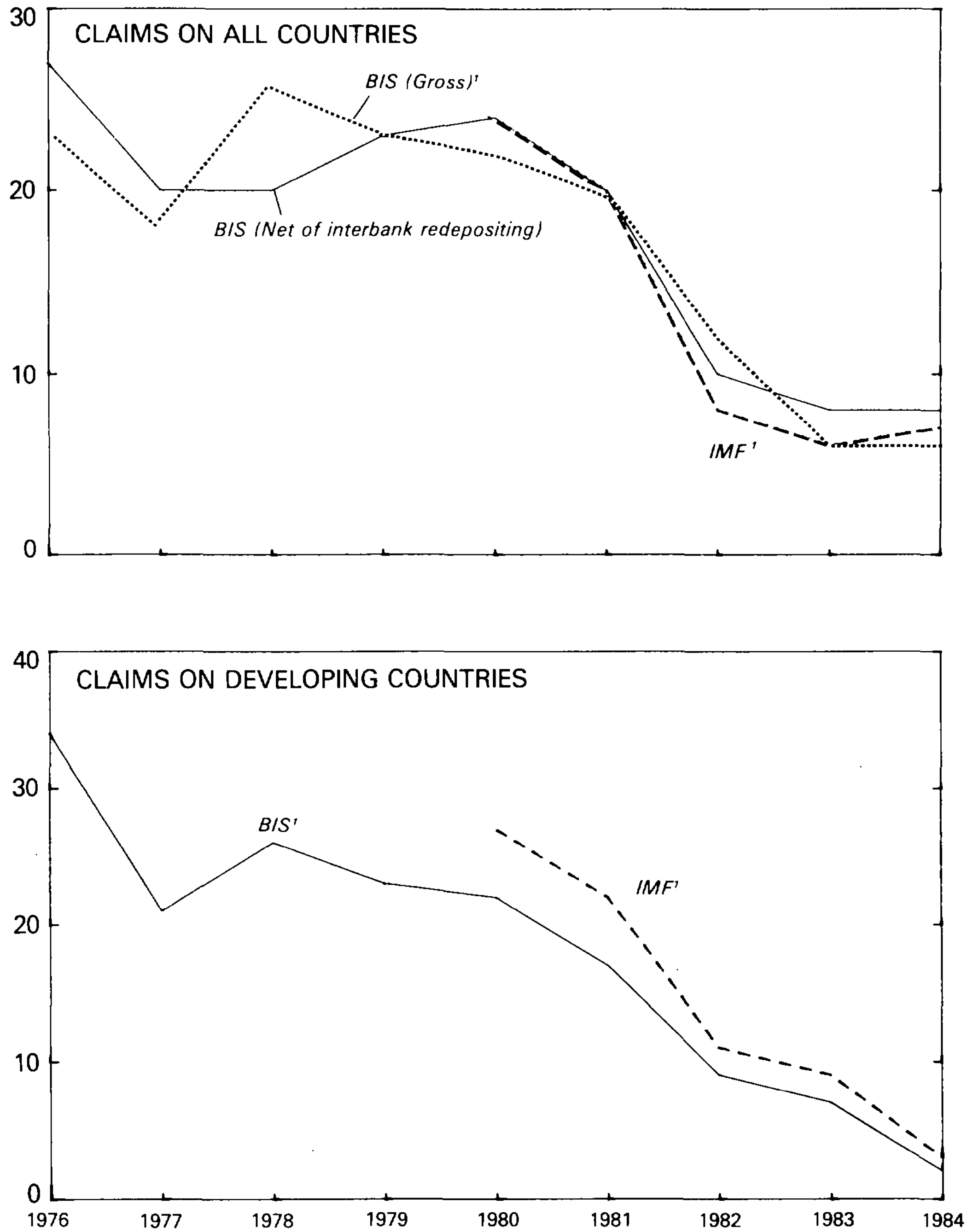
Growth in interbank claims on industrial countries accelerated to 8 percent in 1984, in contrast with a further slowing to 3 percent in lending to nonbanks (Appendix Table II). Moreover, interbank lending

1/ The Fund's IBS are compiled in accordance with balance of payments methodology and are thus based on the geographical location of banks, rather than on their nationality. Thus, this review of recent developments does not reflect interbank lending within the major financial centers nor does it net out redepositing between banks when recording cross-border flows. As all references in this paper are to cross-border flows, the term "cross-border" is hereafter omitted.

CHART 1

GROWTH RATE OF INTERNATIONAL BANK CLAIMS, 1976-84

(In percent)



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

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

Table 2. Total Cross-Border Bank Lending and Deposit-Taking, 1982-First Quarter 1985 1/

(In billions of U.S. dollars)

	1982	1983	1984	1984 1st Half	1984 2nd Half	QI 1984	QI 1985
Lending to 2/	186	139	187	97	90	31	56
Industrial countries	123	92	114	65	50	30	49
Of which:							
United States	(61)	(38)	(36)	(27)	(9)	(7)	(8)
Japan	(...)	(10)	(19)	(8)	(11)	(10)	(10)
Developing countries 3/	51	38	15	4	11	-3	-1
Offshore centers 4/	25	7	30	11	19	-3	8
Other transactors 5/	-1	6	6	--	6	-2	-1
Unallocated (Nonbanks) 6/	-12	-4	21	18	4	9	1
Memorandum items:							
Capital-importing developing countries 3/7/	...	38	15	5	11	-2	-1
Major borrowers 8/	...	13	9	3	6	--	-1
Non-oil developing countries 3/9/	41	31	17	6	11	-1	-1
Deposit-taking from 10/	188	161	191	115	77	41	71
Industrial countries	150	88	131	78	53	37	54
Of which:							
United States	(107)	(32)	(11)	(28)	(-16)	(6)	(5)
Japan	(...)	(15)	(12)	(4)	(7)	(9)	(10)
Developing countries 3/	4	29	25	14	11	-3	-1
Offshore centers 4/	25	26	19	13	6	-1	18
Other transactors 5/	4	10	2	--	2	--	-3
Unallocated (Nonbanks) 6/	6	8	14	10	4	8	3
Memorandum items:							
Capital-importing developing countries 3/7/	...	38	27	15	12	2	-3
Major borrowers 8/	...	12	18	7	12	3	--
Non-oil developing countries 3/9/	17	32	23	13	10	--	-6
Change in net claims on 11/	-2	-22	-4	-17	13	-10	-15
Industrial countries	-26	4	-16	-13	-4	-7	-5
Of which:							
United States	(-46)	(6)	(25)	(-2)	(27)	(1)	(4)
Japan	(...)	(-5)	(7)	(3)	(3)	(--)	(--)
Developing countries 3/	47	9	-10	-10	1	--	--
Offshore centers 4/	--	-19	11	-1	13	-2	-10
Other transactors 5/	-5	-4	4	--	4	-2	1
Unallocated (Nonbanks)	-18	-12	7	7	--	--	-2
Memorandum items:							
Capital-importing developing countries 3/7/	...	--	-12	-11	-1	-4	3
Major borrowers 8/	...	1	-9	-4	-5	-2	-1
Non-oil developing countries 3/9/	24	-1	-6	-9	2	-2	5

Note: Components may not add due to rounding.

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

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

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

3/ Excluding offshore centers.

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

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

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

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

8/ Consisting of Argentina, Brazil, Indonesia, Korea, Mexico, the Philippines, and Venezuela.

9/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed above), Algeria, Indoensia, Nigeria, and Venezuela.

10/ 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.

11/ Lending to, minus deposit-taking from.

did not fall back by its normal seasonal amount in the first quarter of 1985. This growth in interbank lending occurred despite several factors which have been operating to slow interbank lending--including notably the impact of higher capital asset ratio requirements on U.S. banks; issuance of medium-term bonds by banks to lengthen the maturity of their funding positions; use of futures contracts rather than interbank positions for interest rate matching; and some disintermediation as nonbanks have increasingly issued debt instruments, often backed by commercial bank stand-bys, directly to other nonbanks.

A number of developments appear to explain the growth in interbank activity. A large proportion of the growth in interbank claims represents an increase in claims between banks and their related offices abroad (i.e., intrabank claims). On occasion, local funding problems of these related offices have led to greater lending to them by their parent institutions. Since the increase in interbank lending was almost entirely directed--in roughly equal amounts--to countries with major securities markets (Japan, the United Kingdom, and the United States), a part of this activity may reflect funding of trading portfolios of securities held by bank offices in those markets. Moreover, activity may have increased at times of foreign exchange volatility, as banks covered foreign exchange positions in the deposit market. Lastly, the possibility was raised by some banks that a degree of tiering in the interbank market might have caused some recycling of deposits received by highly regarded banks.

Data on the ownership of international assets recently compiled by the Bank for International Settlements throw some light on the role of different national groups of banks in lending. 1/ While these statistics are not adjusted for the effect of exchange rate movements, they nevertheless provide valuable insight into the relative importance of different groups of banks in lending to nonbanks, other banks, and their own related offices. Broadly, more than half of the increase in international assets of banks in industrial countries during 1984, and two thirds of total interbank activity, was accounted for by an increase in claims of banks on their own related offices, an activity that was almost totally due to Japanese and U.S. banks. The increase in assets between unrelated banks was more than fully accounted for by Japanese banks. Lending to nonbanks by Japanese banks also more than accounted for the total increase in such lending. Thus, Japanese banks were overwhelmingly the dominant source of lending to other banks and nonbanks. By contrast, U.K. and U.S. banks reduced their claims on other banks and nonbanks.

1/ "The Nationality Structure of International Bank Market and the Role of Interbank Operations," Bank for International Settlements, May 10, 1985. The analysis based on ownership of assets includes cross-border claims in all currencies and foreign currency claims on local residents.

Measures of bank lending to developing countries are subject to considerable uncertainties. Efforts are underway in the Fund's Bureau of Statistics to enhance the quality of banking statistics. Data in this paper have been corrected for identified misrecording of lending in 1983 and 1984. Following these adjustments, it is estimated that the resulting data on international banking activity reflect a net under-recording of flows to developing countries. 1/ A fuller description of measurement issues is contained in the background paper.

The growth in bank claims on developing countries 2/ slowed to 3 percent during 1984 ($15 billion) from a rate of 7 percent in 1983 ($38 billion) and continued at about that pace during the 12-month period ended in the first quarter of 1985. The sharp decline in bank lending to developing countries was associated with lower current account deficits of those countries in 1984, which were more than covered by nondebt-creating flows and net flows from official creditors. Banks remained reluctant to lend to many developing countries--especially those experiencing payments difficulties and to those countries with whom banks had large exposures. Almost two thirds of bank lending to developing countries in 1984 took place through the interbank market, compared to one third during 1982-83. This higher share was partially related to the transfer of claims on nonbanks, principally in the private sector, to claims on the monetary authorities which carry an official guarantee. Nearly 60 percent of bank lending to developing countries in 1984 was in the form of concerted lending. 3/

1/ Lending is measured as the change in bank claims adjusted for exchange rate fluctuations. Over counting of bank claims in certain developing countries may occur when loan claims on nonbanks are transferred to banks (i.e., the Central Bank). Such transfers should result in an increase in interbank claims offset by a decline in claims on nonbanks. However, international banks that report their claims on banks and nonbanks may not properly reclassify their claims on nonbanks, which would result in over counting of those claims and an overestimation of lending. On the other hand, data on bank claims have been reduced due to loan charge-offs, sales of banks' claims to nonbanks, and the exercise of official guarantees. Thus, recorded new lending could be underestimated. (According to an estimate by the staff of the Board of Governors of the Federal Reserve System, U.S. banks' lending to non-OPEC developing countries may have been understated by $3 1/2 billion during 1983-84, or by 3 1/2 percent. Similar estimates are currently being developed for other key financial centers.) Another source of under-counting is that banks' holdings of securities have been underrecorded because some major banking centers exclude securities from the geographical analysis of their banks' positions.

2/ All references to developing countries exclude the major offshore banking centers (the Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore).

3/ Concerted lending (or "new money") refers to equi-proportional increases in exposure coordinated by a bank advisory committee.

Disbursements under concerted lending packages totaled $10.3 billion in 1984, of which Brazil and Mexico accounted for $9.4 billion.

In the Western Hemisphere (excluding the offshore centers of the Bahamas, the Cayman Islands, the Netherlands Antilles, and Panama), international banks increased their claims on developing countries by $7.4 billion, or 3 percent, which was less than disbursements under concerted lending packages because some banks reduced their claims on certain countries in the region, principally Argentina and Venezuela.

Outside the Western Hemisphere, a number of developing countries continued to have access to spontaneous lending. Indeed, access to bank credits by certain countries improved in 1984. Bank claims on developing countries in Europe grew by 4 percent ($2.6 billion). Lending to Turkey, Hungary, Greece, and Yugoslavia amounted to $3.5 billion, while bank claims on Romania declined by $0.6 billion. Lending to developing countries in Asia (excluding Hong Kong and Singapore) totaled $5.6 billion in 1984 or a 6 percent increase in bank claims. Nearly two thirds of this increase, or $3.5 billion, was accounted for by lending to Korea. Other active borrowers in Asia included Malaysia ($1.4 billion), China ($1.0 billion), and Thailand ($0.9 billion). Countries in Africa experienced a decline in bank claims in 1984, falling by $1.0 billion or 2 percent; lower claims on South Africa more than accounted for this decline. Banks' claims on countries in the Middle East contracted by $0.9 billion in 1984. Sharp declines in banks' claims on the United Arab Emirates, Iran, Israel, and Kuwait were partly offset by lending to Egypt and Saudi Arabia.

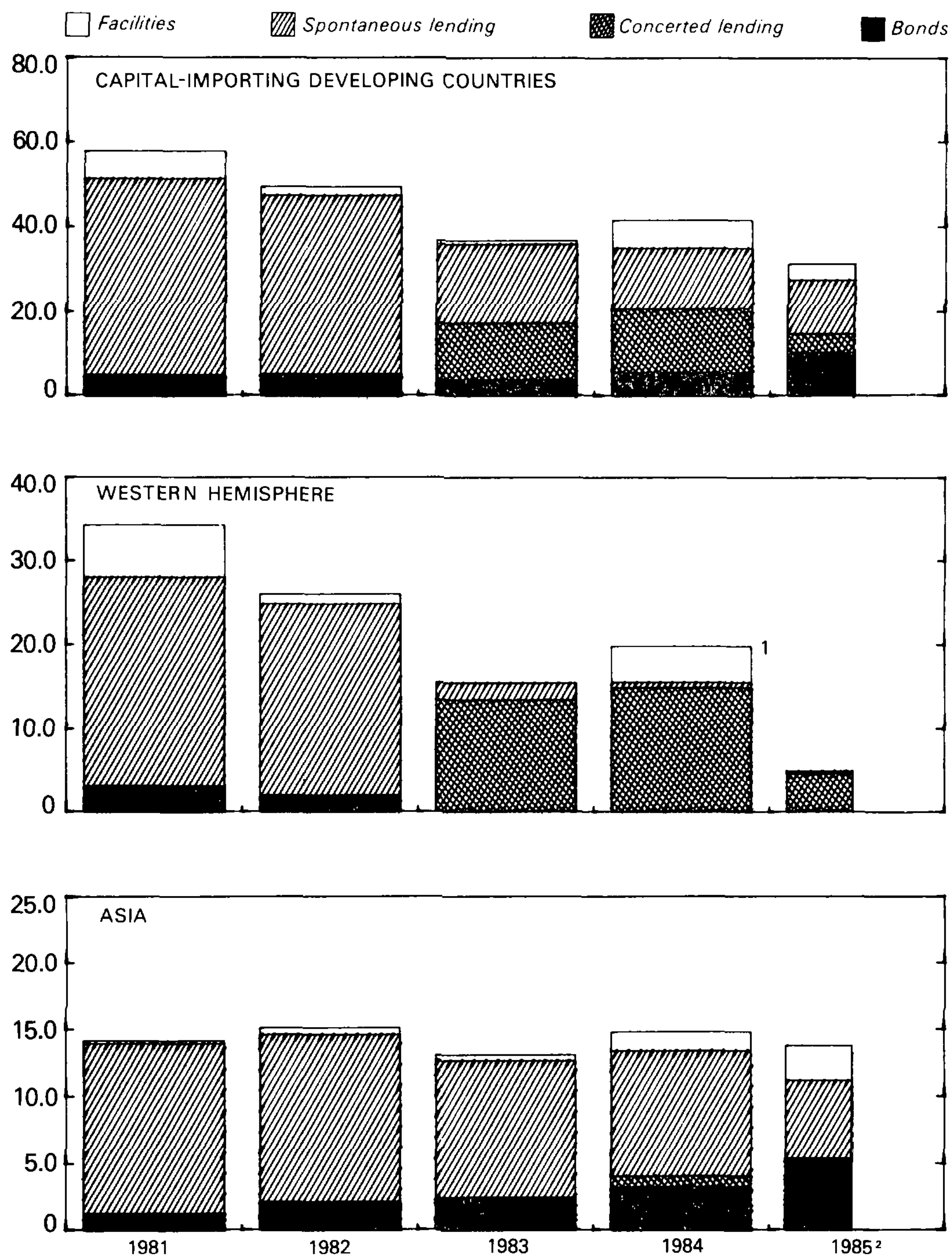
Developments in new publicized long-term international bank credit commitments to developing countries provide some indications of recent capital market conditions for these borrowers (Chart 2). New bank commitments to developing countries declined in 1984 to $31 billion from $35 billion in 1983 (Appendix Table III). All regional groupings of developing countries recorded virtually unchanged or lower bank commitments in 1984, with countries in Africa and the Middle East reporting the greatest percentage reductions. New commitments to developing countries slowed further to $9 billion in the first half of 1985, compared with $18 billion in the first half of 1984. During the first half of 1985, new bank commitments to developing countries in the Western Hemisphere dropped to $2.4 billion--virtually all was concerted lending--while there were almost no bank commitments to developing countries in the Middle East.

In the meantime, bank commitments to developing countries in Europe doubled in the first half of 1985 (to $2.3 billion) compared to the same period in 1984. Centrally planned economies, excluding Fund member countries, experienced a sharp increase in bank credit commitments in 1984 and the first half of 1985; during that period, these commitments reached an average annual level of $2.7 billion in contrast to the average annual commitment level of $0.4 billion during 1982-83.

CHART 2

BOND ISSUES AND LONG-TERM COMMITMENTS OF CREDITS AND FACILITIES TO CAPITAL IMPORTING DEVELOPING COUNTRIES, 1981- FIRST HALF 1985

(In billions of U.S. dollars)



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

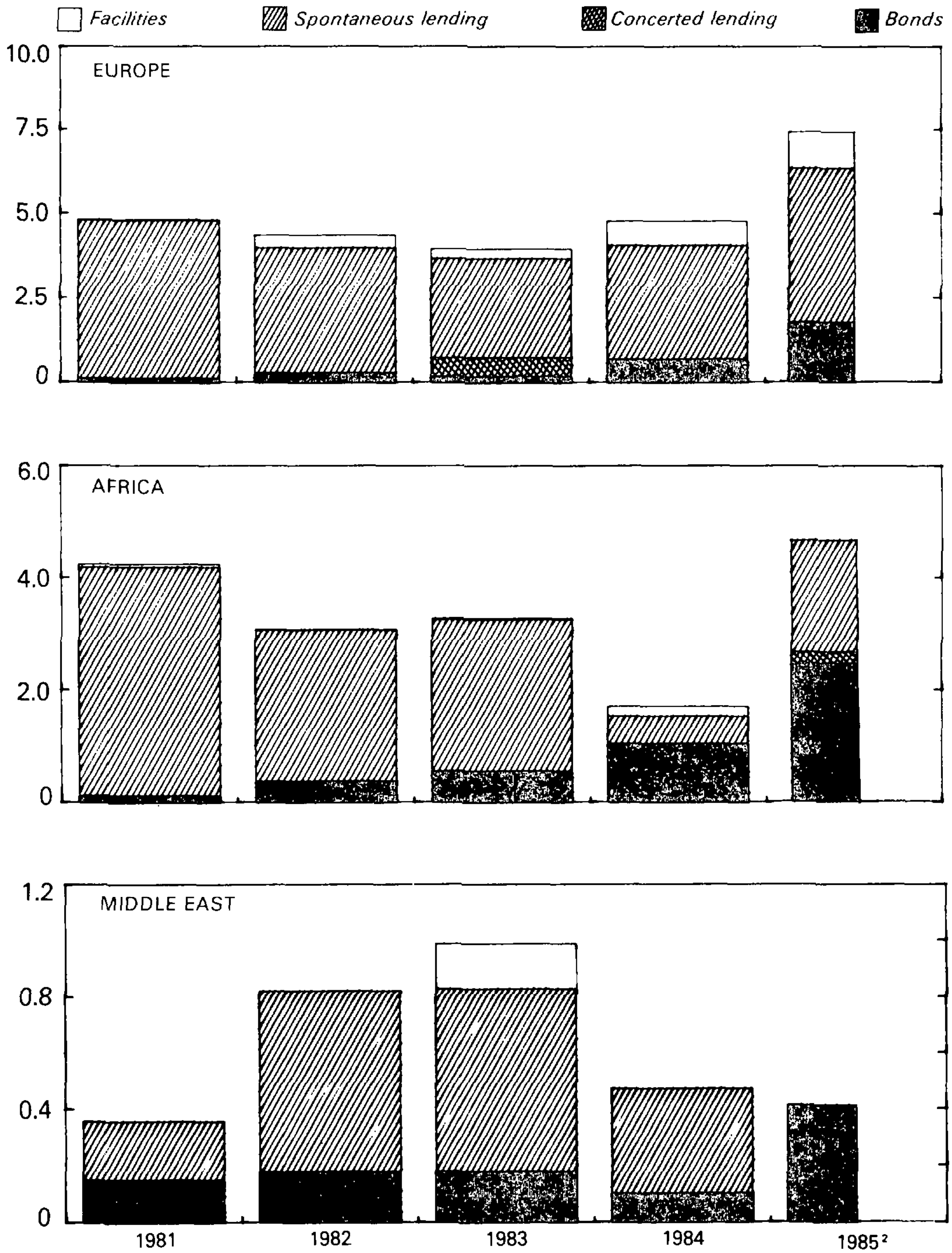
[1] Includes a facility arranged for Mexico.

[2] First half annualized

CHART 2

BOND ISSUES AND LONG-TERM COMMITMENTS OF CREDITS AND FACILITIES TO CAPITAL IMPORTING DEVELOPING COUNTRIES, 1981- FIRST HALF 1985 (Concluded)

(In billions of U.S. dollars)



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

[2] First half annualized

Included in these commitment data for 1984 and the first half of 1985 are concerted lending packages on which nine member countries reached agreements (at least in principle) with their bank creditors. In 1984, firm long-term commitments for concerted lending to these countries totaled $15.7 billion, or about half of new long-term commitments to developing countries in that year, which was up from about 40 percent in 1983 (Appendix Table IV). During the first half of 1985, five countries obtained firm commitments for concerted lending amounting to $2.3 billion, or about one quarter of new external commitments during that period. During 1984 and the first half of 1985, nearly all new bank commitments to developing countries that had recently restructured their debt (i.e., seven countries in the Western Hemisphere, the Ivory Coast, and the Philippines) consisted of concerted lending.

During 1984 and the first half of 1985, restructuring agreements were reached (at least in principle) with 21 countries, of which 12 had previously restructured their debt since 1982. 1/ The amount of bank debt restructured in agreements signed or agreed in principle, excluding short-term debt that was rolled over, is estimated at $105 billion during 1984 and the first half of 1985, compared to $38 billion in 1982-83. The tripling in the volume of bank debt restructured was largely related to the development of multiyear debt restructuring. Total long-term debt that was restructured represented 21 percent of the stock of bank debt of developing countries in 1984, compared to 6 percent in 1983. The amount of short-term debt rolled over or converted into medium-term loans under agreements concluded with a debt restructuring is estimated at $36 billion at the end of June 1985, or unchanged from the end of 1984. Such debt totaled $28 billion at the end of 1983.

The maturity of outstanding bank debt of countries outside the reporting area of the BIS continued to lengthen during 1984 (Appendix Table V). The decline in the share of debt with a remaining maturity of one year or less partly reflected the restructuring of medium-term loans and a deliberate effort by some borrowers with access to spontaneous medium-term bank credits to improve the maturity structure of their bank debt. While the maturity of outstanding bank credits has lengthened, undisbursed credits as a share of total outstanding bank debt continued to decline in 1984. Undisbursed credits were only 15 percent of outstanding disbursed credits in 1984, compared to nearly 25 percent in 1980 (Appendix Table VI).

The OECD data on the maturity of new long-term bank credit commitments indicate that average maturities for industrial countries remained basically unchanged in 1984, while maturities for developing countries--especially non-oil developing countries--lengthened. During the first half of 1985, the average maturity of new commitments to developing countries shortened (Appendix Table VII and Chart 3).

1/ These cases exclude agreements for temporary deferment or for new financing only.

Spreads on long-term bank credits declined sharply in 1984 and early 1985, as banks competed heavily for creditworthy borrowers both against each other and with other segments of the international capital market, and as bank credit commitments to developing countries became increasingly limited to the most creditworthy borrowers. As a result of these developments, the differentiation in spreads applied to various groups of borrowers, which had increased during 1982-83, declined sharply in 1984 and the first half of 1985 (Chart 3). For developing countries with spontaneous access to bank credits, the difference in their average spread and the spreads for industrial countries was the least since 1980.

Significant changes occurred in the pattern of deposit-taking by international banks in 1984. Overall deposit-taking rose sharply to $191 billion in line with developments in bank lending, in particular, with interbank lending. Industrial countries as a group continued to be the largest single depositor with the international banking system, accounting for two thirds of total deposit-taking. Within industrial countries, the share supplied by the United States fell to 8 percent in 1984 from 34 percent in 1983. Depositing by nonbanks in industrial countries continued to decline in 1984, totaling $12 billion, or only one third of the amount in 1982. Nonbank depositors in industrial countries may have shifted into high quality securities issued by nonbanks.

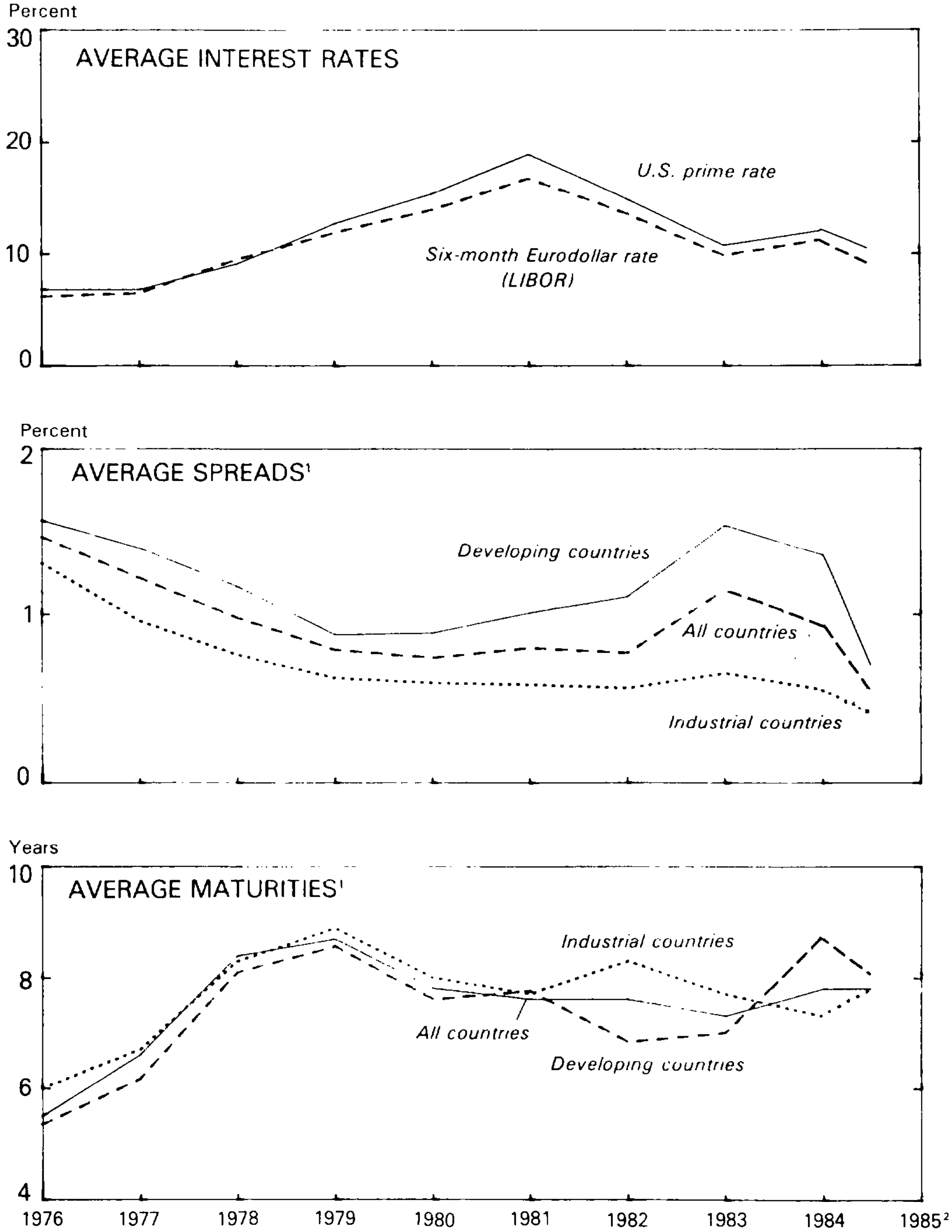
During 1984, deposit-taking from developing countries was $25 billion, or $4 billion less than in the previous year. However, unlike in 1983, depositing was mainly by banks--in particular, the monetary authorities. Interbank deposits of developing countries rose by $21 billion in 1984, compared to $6 billion in 1983. On the other hand, deposit-taking from nonbanks in developing countries declined to $4 billion in 1984 from $23 billion in 1983. This deceleration in new bank deposits of nonbanks could be interpreted as reflecting a reduction in capital flight from developing countries, although there may have been some reversal of this trend in early 1985.

As a result of the developments in lending and deposit-taking in 1984, there was a change in the pattern of net bank financing flows. Although the industrial country group returned to being a net supplier of funds to the international banking system in 1984, after being a small taker of funds in 1983, the distribution of net financing flows did not return to historical patterns. In particular, the United States was the largest net borrower from the international banking system ($25 billion), which contrasts with its historical role as the major supplier of funds. Net financing from the international banking system amounted to more than one quarter of the current account deficit of the United States.

Japan also was a net borrower from the international banking system ($7 billion), while recording a current account surplus of $36 billion. This pattern of flows in part reflects direct investment by Japanese nonbanks in international bond markets, which may partly

CHART 3

TERMS ON INTERNATIONAL BANK LENDING COMMITMENTS, 1976-FIRST HALF OF 1985



Sources. Organization for Economic Cooperation and Development, *Financial Statistics Monthly*, Federal Reserve Bulletin for Prime Rate and IMF *International Financial Statistics*

[1]New publicized long term international bank credit commitments

[2]First half only

account for the buoyant activity in those markets. During 1984, developing countries became net suppliers of funds to the international banking system ($10 billion), as their aggregate current account deficits were more than covered by nondebt-creating flows and net lending from official sources.

3. Bonds and issuance facilities

New issuance activity in international bond markets expanded to record levels during 1984-85. Issues of international bonds reached $110 billion in 1984, consisting of $82 billion in Eurobonds and $28 billion in foreign bonds. Lending through bond markets (bond issues net of redemptions) also reached the unprecedented amount of $84 billion in 1984 (Table 3). In the first half of 1985, net issues rose further to an annualized amount of $119 billion. Recently, international bonds have increasingly become a substitute for syndicated loans--at least for those borrowers viewed as the best credit risks.

The importance of floating rate notes (FRNs) continued to grow in 1984; 34 percent of new bond issues were in the form of FRNs compared to 25 percent in 1983. Industrial country borrowers and international organizations together accounted for 95 percent of total international bond issues during 1984 and the first half of 1985. New issues by developing countries kept pace with the overall expansion in the bond market during this period as their share remained constant, albeit at a low level (5 percent). Total issues by developing countries rose to $5.3 billion in 1984 from $3.3 billion in the previous year. During the first half of 1985, developing countries issued bonds amounting to $4.9 billion. Five developing countries (Greece, Korea, Malaysia, South Africa, and Thailand) accounted for over two thirds of the issues during 1984 and the first half of 1985.

These developments in the bond market can be attributed to several factors. First, as discussed earlier, surpluses have arisen in countries and financial sectors, with a preference for investment in securities, directly or through nonbank intermediaries. Meanwhile, deficits have arisen in sectors, many of whose borrowers enjoy sufficient creditworthiness to tap nonbank savings directly to meet their financing requirements. Certain sovereign and corporate borrowers among the industrial countries have been able to raise funds more cheaply in the bond market than in the bank credit market and, in some cases, have been tapping the bond market in order to refinance outstanding bank credits.

Second, bond purchasers have also been encouraged by continued low rates of inflation in industrial countries, and in certain markets by a steeply upward sloping yield curve. Real yields have been sufficiently

Table 3. Developments in International Bond Markets, 1980-First Half of 1985

	1980	1981	1982	1983	1984	1985 First Half 1/
	(In billions of U.S. dollars)					
Bond market lending (net of redemptions) 2/	28	36	58	59	84	119
Of which: purchases by banks	(9)	(2)	(6)	(11)	(24)	(42)
By category of borrower						
Industrial countries	20	31	50	47	70	98
Developing countries	2	3	3	2	4	7
Other (including international organizations)	6	7	9	11	10	14
	(In percent)					
By currency of denomination						
U.S. dollar	43	63	64	57	64	67
Deutsche mark	22	5	7	9	6	6
Swiss franc	20	16	15	18	12	8
Japanese yen	5	6	5	5	6	6
Other	10	10	9	11	12	13
Share purchased by banks	32	6	10	19	29	35
	(In percent per year)					
Interest rate developments						
Eurodollar deposits 3/	14.6	16.8	13.2	9.7	10.8	8.6
Dollar Eurobonds 4/	12.6	14.4	15.0	12.6	12.7	11.7
Deutsche mark international bonds 4/	8.9	10.1	8.9	7.9	7.9	7.6

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

1/ On an annualized basis.
2/ This series is net of redemptions but is not adjusted for double-counting due to bank purchases of bonds.
3/ Three-month deposits.
4/ Bonds with remaining maturity of 7-15 years.

high to prove attractive to investors, while for many borrowers, the cost of these real interest rates has been offset by the advantages of achieving desired balance sheet restructuring.

Third, activity of banks in the securities markets has continued to grow. The traditional distinction between the bank credit and bond markets has become less relevant as banks have become major purchasers and issuers of bonds. Banks purchased about $24 billion in international bonds, or 29 percent of new issues; within the FRN market, banks played an even larger role--buying half of the new issues. Banks have increased their bond portfolio as part of a general trend toward "securitization" of their balance sheets. In addition, banks have also been under pressure from their supervisors to increase their capital asset ratios. Banks have been the largest single issuer of FRNs, using the funds to increase their capital base and improve their liquidity position.

Factors related to those discussed above have influenced the growth of an international market in short-term paper. Banks have attempted to maintain business relations with those clients that wish to enter the evolving short-term securities market by providing international back-up facilities for issuance of such notes which is one element of banks' off balance sheet activities. Under such facilities a group of banks stands ready over the medium term to purchase the borrower's short-term notes that cannot be placed in the market on certain agreed terms. Reflecting their high creditworthiness, the most active users of these facilities have been sovereign borrowers, including a few developing countries, and high-quality corporations, especially from the United States. The amounts committed under such facilities (excluding merger-related standbys) jumped to $29 billion in 1984 from $10 billion in 1983. Activity in these facilities during the first half of 1985 increased to an annualized rate of $40 billion.

To some degree, the appetite of financial institutions for securities may have been influenced by factors which may not be entirely sustainable. Some financial institutions have preferred negotiable instruments to book claims in the belief that negotiability would, of itself, increase liquidity. The steep upward sloping yield curve in U.S. dollar assets, together with declining interest rates, has enabled banks to purchase FRNs and other securities at a profit by funding at very short term. Also, the privileged servicing of the modest volume of outstanding bonds for countries engaged in debt restructuring may have encouraged a belief that such instruments were inherently much less risky, even if they were to account for a significant proportion of a country's total debt. Finally, banks have raised capital to reassure market or supervisory concerns about their soundness by issuing FRNs which, in some cases, have been held by other banks. Although considered as part of capital by the issuing bank, these FRNs have tended to be viewed as a money market instrument by the purchasing bank and not as an equity instrument.

Finally, the growth in securities activity has been stimulated by liberalization and innovation in financial markets. Financial liberalization measures were announced in a number of major financial centers. In addition, the growth of currency and interest rate swaps has increased the ability of market participants to arbitrage differences in financial market conditions, especially in medium-term maturities. Such transactions have been estimated at $80 billion in 1984, or triple the level in 1983. Swaps have also been utilized by some borrowers to avoid saturating a market with debt issues in their name. Banks have been major participants in interest rate swaps. They have issued fixed interest rate bonds with an associated interest rate swap in order to secure long-term funds at variable interest rates which were below LIBOR. During 1984 and early 1985, these developments tended to integrate international financial markets more closely. 1/ The general trend toward liberalization and innovation in financial markets is discussed in Section III.

III. Review of Current Developments

The last three years have been marked by far-reaching changes in international financial markets. Developments in two areas have been of particular importance. First, new issues have arisen concerning the process of resolving the debt-servicing difficulties of developing countries. Second, the structure of financial markets has been changed by liberalization and by the spread of innovative financing techniques. Developments in these areas are reviewed below.

1. The debt situation

In discussions with staff, banks and country authorities pointed to a number of key developments in the debt situation. Several of these developments concern evolution in techniques for restructuring and new financing. Other developments relate to changes in bank attitudes to lending to developing countries, with regard to both concerted financing and spontaneous flows.

a. Developments in techniques for restructuring and concerted lending

A key development in 1984-85 has been the adoption by bank creditors of a medium-term perspective in certain debt restructurings. In particular, multiyear restructuring agreements (MYRAs) were developed to smooth debt amortization profiles and, by providing a clear planning horizon, to facilitate the return to international capital markets of countries that had demonstrated significant domestic and external adjustment. On this basis, banks negotiated MYRAs with Ecuador, Mexico,

1/ Details of these developments, especially liberalization measures, are described in the background paper.

and Venezuela, during 1984 and the first half of 1985. In this connection, the process of enhanced surveillance was developed to involve the Fund more regularly and closely in the monitoring of quantified, forward-looking, economic programs and to provide information about economic developments and policies to creditors; to improve banks' risk evaluation through timely and comprehensive information and through familiarization with the Fund's techniques for forward-looking assessment of domestic policies; and to foster a shift in responsibility for lending decisions back to commercial banks by avoiding on/off financing indications from the Fund.

A detailed discussion on the evolution of MYRAs and creditors' monitoring arrangements was contained in "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" (EBS/85/173, 7/23/85). As indicated in the summing up of that discussion (EBM/85/132, 9/4/85), Executive Directors supported the practice of enhanced surveillance as a means to promote the normalization of creditor/debtor relations in connection with MYRAs. Directors stressed that it would be important that enhanced surveillance not substitute for normal stand-by or extended arrangements, or transform the Fund into a credit rating agency for commercial banks. For these reasons, Executive Directors thought that enhanced surveillance should be employed essentially to help promote MYRAs, although not all MYRAs might be associated with enhanced surveillance. They also considered that, in the future, the Fund should attempt to limit the duration of this procedure to about the consolidation period of a MYRA. To avoid the risk of the Fund providing on/off indications to banks, most Executive Directors emphasized that the staff should take no active part in the negotiation or design of trigger mechanisms, although at the request of a member the staff could provide purely technical advice.

Discussions are underway on MYRAs for countries that would not meet the criteria for enhanced surveillance, because they have not established an adequate record of adjustment. In such cases, member countries and bank creditors may agree on a multiyear restructuring to avoid the burdens and uncertainties imposed by multiple annual restructurings. In order to maintain a close link between debt relief and the implementation of adjustment policies, bank creditors may make only subperiods within the consolidation period eligible for restructuring. This approach, known as a serial MYRA, facilitates a periodic review of economic policies and prospects. However, it is important that these periodic reviews be the responsibility of creditors.

The past year has seen a number of developments in the assembling of <u>new financing packages</u>. Commitments for concerted lending during 1985 have been substantially less than the levels of 1983 and 1984. During 1984-85, bank creditors have linked their disbursements of concerted lending to purchases under a Fund program in all cases, except for Colombia. Involvement of the World Bank has increased through cofinancing operations, including the guarantee of a portion of a concerted lending package. Banks have indicated that they see an advantage in cofinancing with the World Bank because of the potential reduction in risk obtained by associating their lending with effective sector policies and productive projects.

Another development has been some adaptation of restructuring and concerted lending techniques designed to preserve traditional business ties to the debtor country. In some restructuring agreements, banks have been permitted to on-lend a portion of the domestic currency counterpart of the rescheduled debt to the private sector. In addition, some recent concerted lending packages have included an option to lend in the form of trade- or project-related loans. In contrast, however, there are cases where banks have pressed for guarantees by the debtor country government on existing loans to the private sector, thereby adding to the debt burden of the public sector. Other developments in restructuring techniques, including redenominations, are discussed in the background paper.

While progress has been made in resolving debt-servicing difficulties, there appears to have been a lessening of banks cohesion in responding to new requests for restructuring and concerted lending. Cohesion has declined as banks' underlying business interests in debtor countries have diverged, and as banks have also made greater provisions for loan losses or have written off in their own books small claims on debtor countries. This process has occurred at varying paces, depending on the nationality, exposure, and size of banks. Therefore, bank attitudes toward new financing packages have become more diverse, which has made the already arduous task of assembling the critical mass necessary for concerted lending even more difficult. The weakening of bank cohesion (which has affected restructuring as well as concerted lending) has been greatest for countries that do not pose a direct systemic risk to the international banking community.

Bank advisory committees, partly in an effort to maintain cohesion, have sought a larger commitment of official resources in new money packages. In this connection, some banks have indicated that cofinancing of project and sectoral loans with the World Bank may induce greater bank cohesion because of reduced risk due to the World Bank's appraisal of project and sectoral policies and to its financial involvement. A crucial issue may be to ensure that additional commitments of official resources effectively catalyze bank financing, rather than substitute for such lending.

Banks have also been evaluating their options for dealing with cases of protracted debt difficulties. In a very few countries with slim prospects of restoring in the near term, a more normal debtor/creditor relationship, banks have agreed to cap or reschedule interest for a portion of interest payments. This approach, at least with regard to medium-term financing, has been adopted. In such cases, the debt burden of countries has increased substantially. However, banks have not agreed to forgiveness of debt, presumably because of concerns that such action could adversely influence other domestic or international borrowers.

b. Banks' lending behavior

A major issue in the present phase of the debt situation is how to catalyze a resumption of significant spontaneous private flows to developing countries that are pursuing policies to correct imbalances in their economies and to resume sustainable growth. In this connection, it is important to assess the implications of recent developments in bank lending. This is not an easy task, however, since data--particularly on the behavior of national groups of banks--is very limited. The trends that do emerge are complex.

The data suggest that some groups of banks may wish to restrain their exposure to many developing countries including, but not limited to, those that have recently restructured their external debt. Notwithstanding the return of Turkey to international capital markets and some spontaneous trade finance for Brazil and Mexico, it is notable that spontaneous lending has been slow to revive for countries that have recently restructured their debt. The reluctance of banks to resume spontaneous lending has been associated with uncertainties concerning those countries' policies and the external economic environment. Moreover, some banks have also cut back or strictly limited their exposure to countries that have not engaged in debt restructuring. Such actions may reflect banks's assessment of countries' economic policies and prospects, but it may also reflect, in some cases, a more general reticent toward lending to developing countries. In particular, many smaller banks may not wish to continue general purpose lending to many developing countries at the present time.

At the same time, banks have continued to lend on very competitive terms to various countries outside the industrial group, including some developing countries in Asia and Europe. Certain centrally planned economies have regained substantial access to international capital markets in 1984 and 1985 after a period of constrained access. In some cases, banks' willingness to lend to countries reflects their assessment of economic policies being pursued, but this is not the case in all instances.

The distribution and terms of bank lending to developing countries in 1984-85 raise some concerns. Banks undertaking substantial loans on very fine terms to certain countries, have on occasion signaled inadequate attention to the implementation of appropriate adjustment policies. At the same time, in some cases, banks have been indicating an unwillingness to lend to countries pursuing adjustment programs. The absence of spontaneous lending to such countries renders the task of economic policy reform more difficult and may impair the quality of banks' existing claims on those countries.

In light of these developments in spontaneous lending to developing countries, attention has focused on the lending pattern of different groups of banks. Analysis of international lending to countries by nationality of banks is limited by the lack of consolidated claims data, especially for banks in Germany and Japan. For Germany, data on a fully consolidated basis with a geographical distribution have recently been published, but available statistics as yet cover claims on only some countries and only for end-1984. For Japan, no official data on the geographical distribution of bank claims on developing countries are published.

Available information for the United States suggests that consolidated claims of U.S. banks on developing countries declined by \$3 billion in 1984, or by about 2 percent (Appendix Table VIII). All size categories of U.S. banks reduced their claims on developing countries, with regional banks reducing their claims most sharply (8 percent). Increases in claims on countries in the Western Hemisphere, which were largely related to disbursements under concerted lending packages, were more than offset by the withdrawal of funds in all other regions, especially in Asia. Consolidated external claims of U.K. registered banks on developing countries were virtually unchanged, at least in U.S. dollar terms, in 1984. An increase in claims on developing countries in the Western Hemisphere was balanced by a decline in claims on developing countries in all other regions.

Similar concerns arise in connection with bank debt restructuring. To secure necessary net financing from banks, the restructuring process has often included agreements to maintain existing short-term exposure, while disbursing funds under concerted lending packages. Exchange rate adjusted claims data, however, suggest that disbursements under concerted lending packages in 1983-84 were greater than the increase in bank claims on certain countries with concerted lending packages. Although write-offs and risk transfers may account for a portion of this difference, analysis of available data indicates that some banks may have, nevertheless, succeeded in reducing their exposure. These leakages may diminish the effectiveness of the present restructuring process and weaken bank cohesion.

The developments described above may raise the question whether some groups of banks may be attempting to hold constant or reduce their overall exposure to many developing countries. At the same time, it is important to note that FRN holdings are excluded from the lending data available for some groups of banks. This exclusion may result in underrecording of bank flows to developing countries that issue FRNs because banks are holders of a high proportion of the FRNs issued by these countries. Also, judging by the overall rise in claims on Asia, it appears clear that national groups of banks for which data are not separately available, have continued to expand their business with countries in that region. Discussions with banks suggest that Japanese banks, in particular, have expanded their lending to Asia during the period under review.

Key factors relevant to the supply of bank lending to developing countries are believed to be the exposure of banks relative to their capital and total assets. Banks have reduced their exposure relative to capital significantly, in considerable part by increasing their capital and reserves. For U.S. banks, exposure to developing countries has returned to the 1977 level in relation to capital and reserves (Chart 4). Nevertheless, the exposure to major borrowers of some individual banks remains large relative to capital. A similar comparison for non-U.S. banks is not possible, since reserves against these banks' claims have been substantial and are not generally disclosed. Such reserves are believed to have increased further in 1984, although the appreciation of the U.S. dollar has inflated claims on developing countries, which are denominated largely in U.S. dollars, relative to these banks' capital, which is largely denominated in domestic currency.

Banks are also seeking to reduce gradually the proportion of their loan portfolio (as well as the proportion of their capital) that is extended to developing countries, partly in light of market concern about high disclosed exposure. However, the slower growth of bank assets in many countries may mean that the process of diluting asset concentration may continue over a number of years. For non-U.S. dollar-based banks, a decline in the U.S. dollar would speed the pace of dilution, with regard both to capital and assets.

Banks' concern about their exposure has recently increased on account of developments in key debtor countries, and greater uncertainty about the world economic outlook. (For some banks, these concerns are compounded by continuing weaknesses in their domestic loan portfolios.) Banks' concern about countries' commitment to adjustment policies has led them to review modalities for limiting increases in their risk exposure to a considerable number of developing countries, whether by avoiding new loans or by pressing for preferred status (e.g., by obtaining guarantees from creditor government agencies or multilateral institutions, and governments of debtor countries).

Thus, there has been a growing interest among banks in forms of legal security, preferential payments arrangements, and guarantees of the debtor country. It would be a concern if the search for such protection were to divert attention from the fundamental need for economic evaluation. Other banks, by contrast, emphasize a need to integrate country risk assessment more fully into their lending decisions. In this connection, information supplied by the Institute of International Finance (IIF) was cited by a greater number of banks than previously. Information on the activities of the IIF is contained in the background paper.

In this environment, an issue that has attracted renewed attention is the impact of banking supervision on international lending. Bank supervisors have been engaged, over the past several years, in a coordinated effort to secure a strengthening of banks' balance sheets by increases in capital asset ratios and by larger reserves against potential loan losses. Capital-asset ratios of banks in most major industrial countries have improved significantly (Appendix Table IX).

Efforts to strengthen banks' balance sheets may have moderated bank lending to some degree. Bank supervisors have, however, weighed the advantages of reinforcing the soundness of the international financial system against the disadvantages created by an overly rapid transition. Bank supervisors have acted in a judicious manner by accommodating the impact of concerted lending on banks' balance sheets.

Supervisory authorities in some countries have also shown flexibility in the treatment of trade finance, when regularly serviced, as regards mandatory provisioning requirements. Nevertheless, a potential problem exists concerning the dynamic impact of provisioning on spontaneous lending, especially trade finance, for developing countries that have undertaken adjustment policies. In some cases, provisioning requirements for developing countries are set on all exposures to a group of developing countries comprising those countries that have restructured in recent years. Such a practice could create a strong disincentive for the emergence of spontaneous lending, including trade finance, because provisioning renders marginal increases in exposure unprofitable.

The staff, in its contacts with bank supervisors, while supporting the need for an adequate strengthening of banks' balance sheets, has pointed out these potentially detrimental effects of certain provisioning practices. Supervisory authorities have acknowledged this potential problem, while indicating that other factors such as economic policies in debtor countries also influenced banks' decisions to lend. Supervisory authorities in several countries are reviewing the possible impact of mandatory provisioning on the availability of new finance to developing countries that are pursuing adjustment policies.

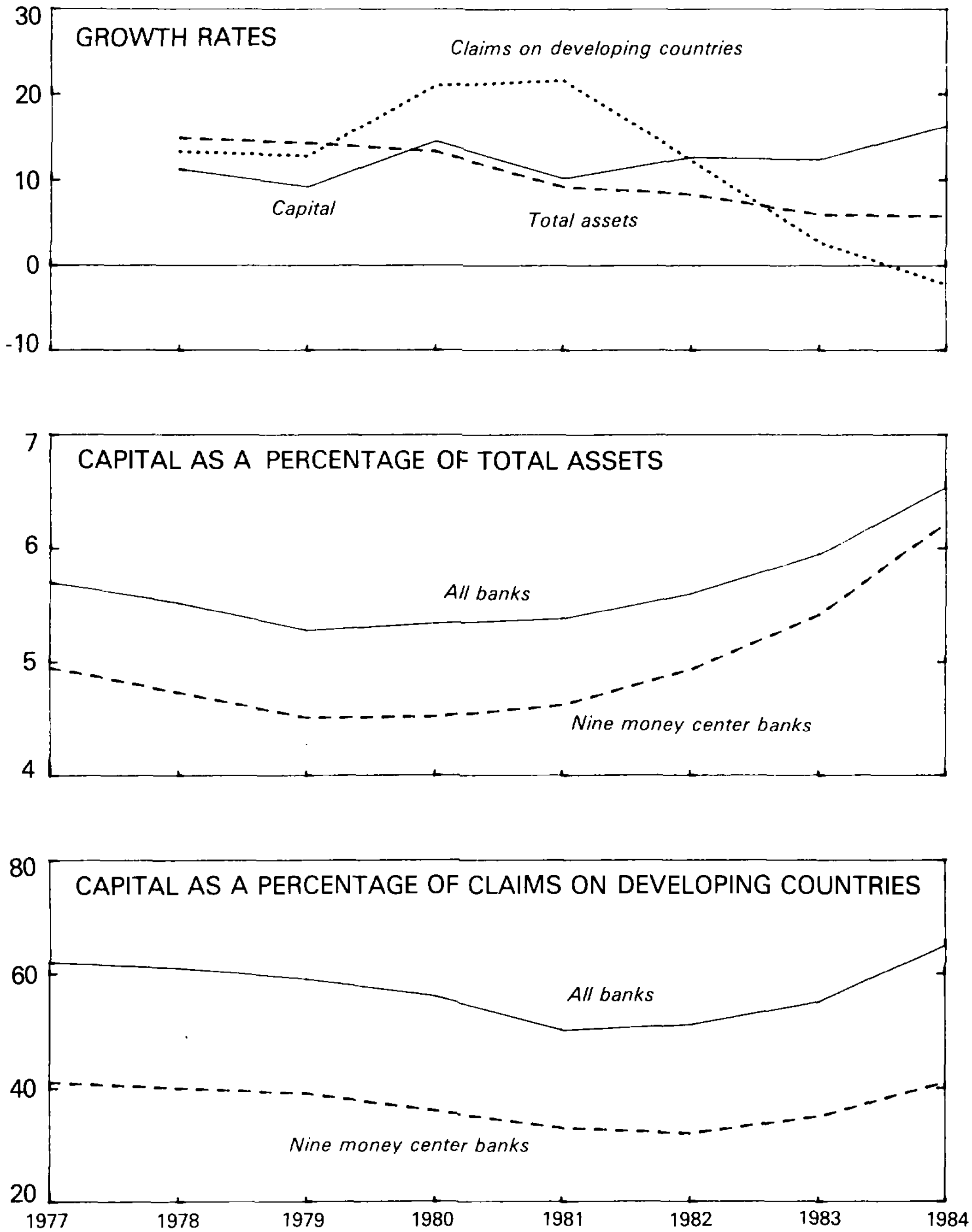
A number of implications for future lending thus emerged from staff discussions with banks and country authorities. First, while a certain number of developing countries remain highly regarded, banks still are very concerned about their exposure to many other developing countries--particularly to countries that have restructured their debt. Banks recognize that appropriate macro- and microeconomic policies in debtor countries remain the key to reducing the risk inherent in their claims. Consequently, they have wished to maintain a linkage between their financing and assessment by the Fund of countries' macroeconomic policies; they are pressing also for greater World Bank involvement in improving the supply response of countries' economies and in providing direct financial support.

Banks have reduced their exposure to some countries through a variety of approaches, including a substantial buildup of reserves in some cases. This process has proceeded at widely different paces for banks of different nationalities, size, and exposure. The number of

CHART 4

SELECTED BALANCE SHEET DATA FOR U.S. BANKS, 1977-84

(In percent)



Source: Federal Financial Institutions Examination Council, *Country Exposure Lending Survey*.

banks committed to medium-term lending to developing countries has decreased. These factors are causing the cohesion of bank creditor groups to diminish. Banks are, however, considerably more forthcoming as regards increasing short-term trade financing and, to a limited degree, project financing; they are seeking to shift the composition of their claims toward such financing. Trade finance is expected by banks to be serviced in a timely way, and it offers synergies with domestic business. For many developing countries, trade and project lending may thus account for the core of spontaneous bank financing during the period ahead.

2. Liberalization and innovation

Banks' recent experience with problem loans--both domestic and international--has been one factor leading them to develop new techniques of risk management, impelled by market and supervisory concerns about a deterioration in their balance sheets. The experience described in the first part of this section has thus contributed to an acceleration in the pace of change in financial markets. Banks and supervisors indicated that these market developments responded to other fundamental sources of change also, and an overview of these influences is provided below. Following this discussion, an assessment is offered of the key elements in the present wave of change in the markets. This section concludes with an appraisal of the concerns sometimes expressed about risks attendant on such rapid changes in market instruments and structure.

a. Sources of change

Developments in macroeconomic policies and in the world economic environment during the 1970s and early 1980s have strongly influenced the structure of financial markets. In particular, high and variable rates of inflation and sharp interest rate fluctuations contributed to the development of floating rate instruments. Large fiscal deficits in some industrial countries increased the availability of risk-free liquid assets, reinforcing pressure on banks to pay market interest rates on deposits.

When a sustained attack on inflation was initiated in the late 1970s, the attendant increase in real interest rates and decline in output caused a sharp deterioration in the creditworthiness of many borrowers. The emergence of widespread external payments difficulties among developing countries and problem loans to various sectors in industrial economies, combined to weaken the balance sheets of many banks. As a result of these developments, banks' funding costs rose relative to the borrowing costs faced by the most creditworthy sovereign and corporate borrowers. These borrowers therefore found that they could issue paper on international markets at costs considerably below those associated with obtaining bank loans. As the share of credit flows accounted for by issuance of debt instruments rose, competition between securities houses and banks intensified. This heightened competition has contributed to the wave of innovation in financial markets.

In response to a deterioration in their balance sheets, many banks have been seeking to increase capital asset ratios. Where banks' stocks were not highly regarded, capital has been raised through the issue of equity-related instruments, or floating rate notes. Intense competition has limited banks' ability to increase profits by higher spreads on lending. Banks have therefore sought to cut costs and also to develop new business activities. A further reaction has been to slow balance sheet growth, and to emphasize activities that have high rates of return relative to their capital weighting. Commercial banks have, therefore, engaged in a rapid expansion of off-balance sheet business, such as securities business, swap transactions, stand-by credits, and trading in financial futures and options, which frequently have not been included in risk categories used for official capital adequacy measurements.

The interaction between innovation and liberalization in financial markets has been complex. In some cases, changes in the pattern of financial flows, financial innovations, and competition in and between markets have provided the impetus for liberalization. In some countries, supervisors have cited the desire to reduce risk concentrations and improve the quality of earnings in the banking industry as a reason to extend the range of bank activities. At the same time, a generally favorable attitude toward free trade in financial services, matched by a domestic concern to foster efficiency and competition, has led to greater liberalization in a number of major financial centers. Thus, the current wave of change in financial markets reflects a confluence of factors: macroeconomic changes, changes in the banking industry, and public policy on competition in financial services.

b. Integration of markets and redistribution of risk

The developments described above have been reflected in a multitude of changes in financial markets. In essence, however, a single process is occurring. Barriers between financial portfolios are being lowered and financial risks are being repackaged and distributed into different portfolios. A key aspect of this repackaging of risk is that financial claims are becoming tradable to enhance their liquidity and their placement in different portfolios.

Liberalization measures and swaps have reduced market segmentation both domestically and internationally. Domestic deregulation has encouraged the lowering of barriers, especially between the banks and securities companies, as a means to stimulate efficiency in the financial services sector. In those countries where banks and securities companies have been separated by law or custom, restrictions on competition have been eased. In some countries, restrictions also have been lifted (or are under review) with regard to participation by banks in stock exchange activity. Banks have also been allowed to compete more keenly for savings by offering deposits at market interest rates, and by a relaxation of restrictions on products or rights of geographical establishment. Market participants have been allowed to issue instruments that previously were not permitted such as floating rate notes and zero coupon bonds.

Measures to liberalize international access to capital markets in major financial centers have contributed to the integration of portfolios that has taken place. Exchange controls have been removed in some major financial centers in recent years, permitting residents access to foreign currency investments. Restrictions on access by foreign borrowers to national markets, and on their ability to borrow in national currencies, have been eased. Withholding taxes on interest payments to nonresidents have been lifted in several countries. Moreover, competition has been enhanced as countries have liberalized *rights of establishment, especially for foreign banks, in banking and* securities markets.

In parallel to these official initiatives, a variety of technical innovations in the market have also resulted in greater integration of markets. The development of interest rate and currency swaps on a large scale represents an innovation comparable in importance to the evolution of floating rate instruments. Swaps integrate international capital markets, by allowing access to portfolios in a financial market independently of the borrower's currency or interest rate preferences, since the borrower can simultaneously undertake swaps to modify these aspects of the transactions. Institutions engaging in a swap transaction are, however, exposing themselves to the risk that their counterparty may not honor the contract. The extent of the associated credit risk depends on intervening currency and interest rate movements. Staff discussions with financial institutions active in this market revealed an extremely wide range of estimates for such credit risk.

At the same time that portfolios have been opened up, securities houses and banks have been developing other new financial instruments to facilitate risk management in financial markets to enhance the liquidity of financial claims. Thus, currency and interest rate options and futures, as well as ECU-denominated assets, permit banks and nonbanks to hedge their exposure.

Marketability of banks' assets has also been increased, a process that has been termed "securitization." Examples are the substitution of FRNs for syndicated lending, the writing of transferable international credits, packaging of existing assets for resale (e.g., mortgages, car loans, and other receivables). Banks are selling high quality assets to other investors for a one-time income gain, while freeing up capital to deploy elsewhere. Securitization has also been driven by a decline in the ability of some banks to intermediate credit profitably due to their diminished market rating relative to prime nonbank borrowers. These borrowers have recognized the opportunity to tap directly nonbank portfolios by issuing bonds and short-term negotiable instruments that compete directly with bank deposits. In an effort to retain business relationships, banks have competed to provide medium-term stand-by facilities for the issuance of such short-term instruments. Many banks are also purchasing this paper for their own portfolios, compensating for the low yield by "cheap" funding through swaps, by carrying paper on an interest rate mismatch basis, or by costing such transactions as part of an overall relationship with the borrower.

c. Some implications of recent changes

The changes described above constitute a major structural development in international capital markets. Liberalization measures in a number of major financial market countries have reduced the barriers to competition among domestic and foreign banks, and increased access to bond markets. At the same time, recent innovations in instruments have provided market participants with new opportunities to tap nonbank savings directly and to hedge against risks associated with volatile interest rates or currencies. These developments should generally result in capital markets that are more closely integrated and more efficient. They also have the potential to allocate financial resources more effectively both domestically and internationally, distributing risks to portfolios better placed to evaluate, diversify, and manage those risks.

Many of the new instruments have significantly altered the sharing of risks associated with exchange rate and interest rate variability and changed the roles of various financial institutions in intermediating flows between ultimate lenders and borrowers. To the extent that these innovations are used judiciously to improve the risk-adjusted return on the assets of financial intermediaries, they can strengthen the process of intermediation. Financial futures and options can offset--or at least redistribute--the risks that arise in volatile financial conditions. The development of fee-earning business which does not appear on banks' balance sheets permits them to strengthen their earnings and capital position. The liquidity of banks may be greatly enhanced by improving the marketability of existing loans and by securing medium-term floating rate funding by issuing securities directly or through swaps at advantageous interest rates.

Notwithstanding these potential efficiency gains, the recent changes pose considerable challenges to supervisory and monetary authorities. They raise issues concerning the nature of the evolving capital markets--in particular, questions regarding transparency, credit analysis, and effective distribution of risk. These issues are discussed below.

The transparency of financial markets has been lessened considerably in recent years, as markets have developed in areas where statistical coverage is as yet very weak. New instruments are affecting credit appraisal by complicating the interpretation of balance sheets. Insofar as an institution's position in swaps and financial futures is not disclosed, it may be very difficult to gauge accurately the degree of risk to which the institution is actually exposed. The reduced transparency makes it more difficult to perform credit analysis on borrowers and to evaluate conditions in financial markets.

These problems highlight the importance of the continuing efforts by monetary institutions, including the Fund, to improve coverage of financial market activity, especially with regard to holdings of securities and off-balance sheet transactions such as swaps and issuance facilities. Moreover, publication by more countries of their banks' consolidated international claims, including the geographical distribution and the corresponding capital data, would permit a greater understanding of developments in international bank lending, especially to developing countries.

An effectively functioning financial system relies crucially on the performance of credit analysis by financial institutions. While new hedging instruments and the sale of debt instruments directly to nonbank investors, reduce the apparent concentration of risk in certain portfolios, risks may in some cases be acquired by portfolios which do not fully understand the nature of these risks, or cannot readily absorb losses that may be associated with them. In the case of recent innovations, such as swaps and international issuance facilities, supervisors and some market participants have expressed concern that the pricing of these instruments may not always fully reflect their credit risks. The intensification of competitive pressures in international financial markets, partially stemming from liberalization, may lead to underpricing of risk taking by market participants.

Adverse affects on individual institutions could, of course, arise where credit assessment is not adequately performed or credit risk not adequately rewarded. Moreover, as risks are unbundled and repackaged, the adequacy of risk management systems--and the division of credit assessment between different parties--may be a source of difficulty. In particular, concern exists that transactors may not rely on their own credit assessment, but on the credit assessment performed by selling or agency institutions and/or the marketability of the asset. Moreover, as claims are converted to negotiable forms, the liquidity of such instruments may at times be overestimated. The stability of financial markets will reflect not only the marketability of claims and dispersion of risks, but whether the risks have been transferred to parties who are well-placed to evaluate and manage these risks.

The spread of deposit-like liabilities and credit-like assets, widely dispersed among bank and nonbank institutions, may raise new issues for the authorities in providing liquidity support in case of emergent strains. The capacity of new market structures and liqudity arrangements to absorb shock is not yet fully tested. At the same time, the need to protect the payments system from the repercussions of disruptions in other segments of financial markets has not diminished. Such protection of the payments system is imperative, but it carries with it a need for vigilance in order that market discipline on financial institutions is not weakened by the perception of explicit or, equally important, implicit guarantees on deposits or other liabilities of financial institutions. Coordinated prudential supervision of financial institutions can reduce this problem of "moral hazard" and diminish potential budgetary costs of providing needed protection to the payments system.

Issues concerning the structure of supervision arise as financial intermediaries branch into new types of activity. As the distinction between commercial banks and other financial institutions becomes less clear, business can more easily shift between these institutions. Thus, as banks increasingly hold marketable assets, supervisory practices that apply to securities houses--including frequent marking to market value of tradable assets and full disclosure of valuations--may become more appropriate. Conversely, to the extent that securities houses engage in transactions--including interest rate and currency swaps--with a considerable credit risk component, it may be important to ensure that their credit evaluation process is well-developed. Changes in the range of activities engaged in by financial institutions, as well as the risk characteristics of assets in their portfolios, may require supervisors to re-evaluate capital adequacy considerations. For example, as banks repackage and sell attractive assets, or extend stand-bys to a new class of customers, they may also increase the risk inherent in their portfolios. Whether a functional or institutional approach to supervision is adopted, detailed knowledge of financial institutions and markets and the links between them will be crucial to detect problems and to respond quickly and effectively.

The changes in financial markets discussed in this paper have thus led to a major strengthening of financial supervision, including concerted efforts by bank supervisors to improve the adequacy of bank capital and liquidity. Together with market pressures, these supervisory initiatives have resulted in a substantial increase in the capital and reserves of many banks, although it must be noted that banks' exposure to off-balance sheet risks has also increased. Supervisory authorities have warned banks that new financing techniques and instruments should be subject to close management control, and that concerted reviews by supervisory and monetary authorities are underway. Many banks have also responded to concerns about their liquidity by extending the maturity of their funding, and by increasing the proportion of their deposits taken from retail sources and other depositors with whom they have a continuing relationship. On the asset side, many banks have viewed more critically the liquidity of their interbank claims, and acknowledged that some holdings of short-term negotiable securities, including government notes, can provide a cushion of primary liquidity, especially in times of strains in the market. Continuing coordinated efforts by supervisory and monetary authorities may be necessary to underpin the stability of financial markets, especially during this transitional period.

Monetary authorities are engaged also in a study to assess the macroeconomic implications of recent changes in financial markets. There are questions whether financial innovations may seriously complicate the definition of monetary aggregates and modify the nature of the transmission mechanism. Keener competition, reduced market segmentation, and new technology have increased the speed at which financial markets adjust, while rising protectionism and structural rigidities have hampered the ability of goods and labor markets to adjust. A greater divergence in adjustment speeds could produce increased volatility of exchange rates and interest rates. Heightened international integration of financial markets may also imply that the impact of policies can spread more widely and more quickly through the international community. To the extent that these concerns appear warranted, increased importance would be attached to enhancing the effectiveness of the Fund's surveillance in order to promote greater harmonization of economic policies and performance, improve resource allocation, and foster orderly conditions in financial markets.

IV. Prospects

In their discussion of the "World Economic Outlook" (WEO) (EBS/85/201, 8/26/85), Executive Directors touched on general prospects for international financial flows. Staff projections indicated that the scale and distribution of these flows in the near term will be strongly influenced by historically large current account imbalances in the industrial countries and small current account deficits in many developing countries. This pattern of current account imbalances suggests continuation of both a high level of international capital flows among the industrial countries and rather limited net flows between the industrial and developing countries.

Under the conditions outlined in the WEO, especially regarding exchange rates and interest rates, it is expected that new issues of international bonds, essentially by industrial country borrowers, will continue to be buoyant both in absolute terms and relative to bank lending. Buoyancy in bond markets is expected to continue for several other reasons. Many of the recent structural changes have enhanced access to international capital markets. Liberalization--whether of access or of instruments--continues in a number of major financial centers. Financial surpluses and deficits will persist in countries and in sectors for which securities transactions provide a major channel for finance.

Commercial banks, in turn, will likely extend further the process of securitization. Financial innovations are expected to play an increasingly important part in credit activity, enhancing the marketability of risks, and carrying further the process of matching instruments to portfolio preferences. These new developments have the potential to enhance the efficiency and stability of financial markets. However, as discussed earlier, coordinated efforts by supervisory and monetary authorities will be crucial to enhance the transparency of these developments and ensure that their inherent risks are adequately managed.

Under the policies and global conditions set out in the WEO, the net financing flows to capital-importing developing countries are projected to continue at a low level in 1986. A high proportion of these flows are projected to be provided by sources other than private creditors. Net external borrowing for capital-importing developing countries is projected to decline to about $31 billion during 1986, of which $22 billion would be financed by long-term borrowing from official creditors.

In discussions with the staff, banks have indicated that the availability of spontaneous financing for many developing countries may remain limited. Banks also indicated that willingness to provide such financing depends closely on policy implementation in borrowing countries and global economic conditions. To preserve or regain access to spontaneous flows, many developing countries, including countries that have not recently restructured their external debt, may thus in effect have little room for maneuver in framing their economic policies.

Trade and project lending by banks is expected to represent the core of spontaneous lending to most developing countries, reflecting among other factors its link with the export activities of banks' customers in industrial countries. Even with adequate trade and project lending, the limited availability of general purpose funds may imply that adverse domestic or external developments affecting individual countries would require further coordinated balance of payments support.

Collaboration between the Fund and the World Bank will be crucial to promote appropriate macro- and microeconomic policies, which will favor more effective investment and can be supported by external capital flows. Banks have indicated that the World Bank can play an important role in facilitating the resumption of bank lending through its involvement in project and sector policies. Export credit agencies also can play an important role, since extension of export cover to countries that are implementing appropriate economic policies can help these countries maintain or regain access to commercial financing.

The composition of capital flows to developing countries is expected to continue to reflect a higher share of foreign direct investment and official transfers. Direct investment flows may grow only at a moderate pace, however, reflecting restrictions in developing countries on direct foreign investment and protectionism in industrial countries. Establishment of the Multilateral Investment Guarantee Agency (MIGA) can contribute to fostering greater private direct investment by reducing noneconomic risks. For many lower income countries, flows from official sources, adapted to their economic situation, will continue to dominate flows from international capital markets.

As a result of differences in the implementation of adjustment programs, as well as differences in the impact of external developments, there has been a divergence in the economic performance and prospects of debtor countries. Reflecting this divergence, restructuring techniques have continued to evolve. MYRAs with enhanced surveillance have been developed to contribute to the process of restoring countries' access to spontaneous financing. At the other end of the spectrum, banks have rescheduled interest payments on long-term credits to very few countries judged to have little or no prospect of regaining access to financing other than trade credits.

Cohesion and burden sharing among creditors are likely to be difficult issues in the period ahead. The task of mustering concerted financing has become more difficult, with a diminished sense of urgency among creditors, and the passage of time causing some divergence in banks' longer term business interests. In the months ahead, bank creditors are likely to review carefully the modalities of providing debt relief, while keeping new techniques attuned to individual debtor countries' prospects for access to different types of finance. Recent developments in adapting financing instruments flexibly to the situations of countries, and to the differing financial circumstances of banks, may need to be further extended.

A central task in the period ahead will concern the need to catalyze adequate financial flows. This process will be dependent on several factors, including the quality of policies in member countries and the close involvement of various sources of finance. Pressures will likely continue for concerted lending packages to include a larger share of official resources or guarantees. Banks are conscious, however, that official support has been predicated on their own willingness to support debtor countries, so as to avoid substituting official resources for private financing. Banks, by demonstrating responsibility and flexibility where adjustment efforts are underway, can protect the quality of their existing claims on developing countries as well as contributing to further progress in reducing systemic risk and restoring sustainable growth.

Table I. Cross-Border Interbank Lending and Deposit-Taking, 1982-First Quarter 1985 1/

(In billions of U.S. dollars)

	1982	1983	1984	1984 1st Half	1984 2nd Half	QI 1984	QI 1985
Lending to 2/	105	102	149	77	72	20	55
Industrial countries	73	77	106	62	44	27	49
Of which:							
United States	(46)	(39)	(24)	(23)	(1)	(5)	(8)
Japan	(...)	(8)	(22)	(9)	(13)	(11)	(10)
Developing countries 3/	16	16	10	5	5	--	-1
Offshore centers 4/	18	6	28	11	17	-4	8
Other transactors 5/	-2	3	5	-1	6	-3	--
Memorandum items:							
Capital-importing developing countries 3/6/	...	17	10	5	5	1	-2
Major borrowers 7/	...	9	7	4	3	3	-1
Non-oil developing countries 3/8/	15	15	10	5	5	1	-2
Deposit-taking from 9/	125	97	152	84	68	22	59
Industrial countries	113	62	119	66	53	29	51
Of which:							
United States	(81)	(16)	(17)	(24)	(-7)	(2)	(3)
Japan	(...)	(15)	(11)	(4)	(7)	(9)	(10)
Developing countries 3/	-9	6	21	8	12	-4	-7
Offshore centers 4/	17	21	11	9	2	-3	16
Other transactors 5/	3	8	2	--	2	-1	-2
Memorandum items:							
Capital-importing developing countries 3/6/	...	14	20	10	9	1	-7
Major borrowers 7/	...	4	15	6	10	2	-1
Non-oil developing countries 3/8/	2	10	17	9	8	--	-8
Change in net claims on 10/	-20	5	-3	-7	4	-2	-4
Industrial countries	-40	15	-13	-5	-8	-3	-2
Of which:							
United States	(-35)	(23)	(7)	(-2)	(9)	(3)	(6)
Japan	(...)	(-7)	(11)	(5)	(6)	(2)	(--)
Developing countries 3/	25	10	-10	-3	-7	4	5
Offshore centers 4/	1	-16	17	2	15	-1	-8
Other transactors 5/	-5	-4	3	-1	3	-2	2
Memorandum items:							
Capital-importing developing countries 3/6/	...	4	-10	-5	-5	--	5
Major borrowers 7/	...	5	-8	-2	-6	1	--
Non-oil developing countries 3/8/	13	6	-7	-4	-3	1	7
Net errors and omissions 11/	20	-5	3	6	-3	2	4

Note: Components may not add due to rounding.

Sources: International Monetary Fund, International Financial Statistics; 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 rates 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 Argentina, Brazil, Indonesia, Korea, Mexico, the Philippines, and Venezuela.

8/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed 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 banks.

10/ Lending to, minus deposit-taking from.

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

Table 11. International Bank Lending to Nonbanks and Deposit-Taking from Nonbanks, 1982–First Quarter 1985 1/

(In billions of U.S. dollars)

	1982	1983	1984	1984 1st Half	1984 2nd Half	Q1 1984	Q1 1985
Lending to 2/	80	37	39	21	18	11	1
Industrial countries	51	15	9	3	5	4	--
Of which:							
United States	(14)	(-1)	(12)	(4)	(8)	(2)	(--)
Japan	(...)	(2)	(-3)	(-1)	(-2)	(-1)	(--)
Developing countries 3/	35	22	5	--	5	-2	--
Offshore centers 4/	7	2	2	--	3	1	--
Other transactors 5/	1	2	1	1	1	1	-1
Unidentified borrowers 6/	-12	-4	21	18	4	9	1
Memorandum items:							
Capital-importing developing countries 3/7/	...	20	5	-1	5	-3	1
Major borrowers 8/	...	4	2	--	3	-2	1
Non-oil developing countries 3/9/	26	15	7	--	6	-2	1
Deposit-taking from 10/	*63*	*64*	*39*	*32*	*8*	*20*	*12*
Industrial countries	37	26	12	12	--	8	3
Of which:							
United States	(26)	(16)	(-6)	(4)	(-9)	(4)	(2)
Japan	(...)	(--)	(1)	(--)	(--)	(--)	(--)
Developing countries 3/	13	23	4	6	-1	1	5
Offshore centers 4/	8	5	8	3	5	1	2
Other transactors 5/	1	2	--	-1	-1	1	-1
Unidentified depositors 6/	6	8	14	10	4	8	3
Memorandum items:							
Capital-importing developing countries 3/7/	...	24	7	6	1	2	3
Major borrowers 8/	...	8	3	1	2	1	2
Non-oil developing countries 3/9/	15	22	6	5	--	1	2
Change in net claims on 11/	17	-27	--	-12	10	-9	-11
Industrial countries	14	-11	-3	-8	5	-4	-3
Of which:							
United States	(-12)	(-17)	(18)	(--)	(18)	(-2)	(-2)
Japan	(...)	(2)	(-4)	(-2)	(-3)	(-2)	(--)
Developing countries 3/	22	-1	1	-6	7	-3	-5
Offshore centers 4/	-1	-3	-6	-4	-2	-1	-1
Other transactors 5/	--	--	1	--	1	-1	--
Unidentified (net) 6/	-18	-12	7	7	--	--	-2
Memorandum items:							
Capital-importing developing countries 3/7/	...	-4	-2	-5	2	-4	-3
Major borrowers 8/	...	-4	-1	-2	2	-3	-1
Non-oil developing countries 3/9/	12	-7	1	-4	5	-2	-3

Note: Components may not add due to rounding.
Sources: International Monetary Fund, International Financial Statistics; 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, Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.
5/ Transactors included in IFS measures for the world, to enhance global symmetry, but excluded from IFS measures for "All countries." The data comprise changes in the accounts of international organizations (other than the Bank for International Settlements) with banks; and changes in identified cross-border banks accounts of nonbanks in centrally planned economies (excluding Fund members).
6/ Calculated as the difference between the amount that countries report as their banks' positions with nonresident banks in their monetary statistics and the amounts that banks in major financial centers report as their positions with nonbanks in each country.
7/ Consisting of all developing countries except the eight Middle Eastern oil exporters (Islamic Republic of Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) for which external debt statistics are either not available or are small in relation to external assets.
8/ Consisting of Argentina, Brazil, Indonesia, Korea, Mexico, the Philippines, and Venezuela.
9/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed above), Algeria, Indonesia, Nigeria, and Venezuela.
10/ As measured by differences in the outstanding assets of depositing countries defined as international bank deposits of nonbanks by residence of depositor.
11/ Lending to, minus deposit-taking from.

Table III. Long-Term International Bank Credit Commitments, 1979-First Half, 1985

(In billions of U.S. dollars)

	1979 1/	1980 1/	1981	1982	1983	1984 2/	1984 1st Half	1984 2nd Half 2/	1985 1st Half 3/
			Long-term external credit commitments						
Industrial countries	24.1	39.3	44.8	51.6	27.9	29.9	12.5	17.5	16.4
Seven largest	12.9	23.4	27.8	31.2	15.0	18.2	5.4	12.8	12.6
Other	11.2	15.9	17.0	20.4	12.9	11.7	7.1	4.6	3.8
Developing countries	50.9	38.3	48.1	44.6	34.9	31.0	18.0	13.0	9.3
Capital-importing	49.8	37.8	47.0	42.6	32.6	29.9	17.6	12.3	8.7
Africa	4.8	2.6	4.1	2.7	2.7	0.5	0.3	0.2	1.1
Asia	11.0	9.2	12.8	12.6	10.4	10.2	4.6	5.6	2.9
Europe	7.8	4.9	4.7	3.7	3.5	3.4	1.2	2.2	2.3
Middle East	0.2	0.7	0.2	0.6	0.7	0.4	0.1	0.3	--
Western Hemisphere	26.0	20.4	25.2	23.0	15.3	15.4	11.4	4.0	2.4
Centrally planned economies 4/	3.6	1.7	0.7	0.2	0.5	2.2	0.7	1.5	1.6
International organizations and unallocated	0.4	0.7	1.0	1.8	3.9	3.5	2.2	1.2	1.6
Total	79.1	79.9	94.6	98.2	67.2	66.6	33.4	33.2	28.9
			Other international long-term bank facilities						
Industrial countries	...	...	46.5	3.1	12.4	47.8	31.5	16.3	17.3
Seven largest	...	...	45.9	1.4	10.6	33.9	28.8	5.0	12.5
Other	...	...	0.6	1.7	1.8	13.9	2.6	11.2	4.8
Developing countries	...	...	6.5	2.1	1.0	6.9	0.8	6.2	2.1
Capital-importing	...	...	6.5	2.1	0.9	6.6	0.6	5.9	1.9
Africa	...	...	0.1	--	--	0.2	--	0.2	--
Asia	...	...	0.2	0.5	0.4	1.5	0.3	1.1	1.3
Europe	...	...	--	0.4	0.3	0.7	0.4	0.3	0.5
Middle East	...	...	--	--	0.2	--	--	--	--
Western Hemisphere	...	...	6.2	1.2	--	4.3	--	4.3	--
Centrally planned economies 4/	...	...	--	--	--	--	--	--	--
International organizations and unallocated	...	...	0.1	0.2	0.1	0.6	--	0.6	0.6
Total	...	...	53.1	5.4	13.5	55.3	32.3	23.0	20.0
			Total international commitments						
Industrial countries	24.1	39.3	91.3	54.6	40.2	77.6	43.9	33.7	33.7
Seven largest	12.9	23.4	73.6	32.6	25.5	52.1	34.2	17.9	25.1
Other	11.2	15.9	17.6	22.1	14.7	25.5	9.7	15.8	8.6
Developing countries	50.9	38.3	54.6	46.8	35.9	37.9	18.8	19.1	11.4
Capital-importing	49.8	37.8	53.5	44.8	33.5	36.5	18.3	18.2	10.6
Africa	4.8	2.6	4.2	2.7	2.7	0.7	0.3	0.4	1.1
Asia	11.0	9.0	13.0	13.1	10.8	11.7	4.9	6.7	4.3
Europe	7.8	4.9	4.7	4.1	3.8	4.2	1.6	2.6	2.8
Middle East	0.2	0.7	0.2	0.6	0.8	0.4	0.1	0.3	--
Western Hemisphere	26.0	20.4	31.3	24.2	15.3	19.7	11.4	8.3	2.4
Centrally planned economies 4/	3.6	1.7	0.7	0.2	0.5	2.2	0.7	1.5	1.6
International organizations and unallocated	0.4	0.7	1.1	2.0	4.0	4.1	2.3	1.8	2.2
Total	79.1	79.9	147.7	103.6	80.7	121.8	65.7	56.2	48.9
Memorandum item:									
Other international medium- and long-term bank facilities, excluding merger-related facilities (in billions of U.S. dollars)	...	...	...	5.4	9.5	28.9	5.9	23.0	20.0

Note: Components may not add up due to rounding.
Sources: Organization for Economic Cooperation and Development, Financial Statistics Monthly; and Fund staff estimates.
1/ Includes only Eurocredit commitments.
2/ Includes agreements in principle with Argentina and the Philippines, and excludes the short-term trade deposit facility for Argentina of $0.5 billion.
3/ Includes agreements in principle with Chile and Colombia.
4/ Excludes Fund member countries.

Table IV. New Publicized Long-Term External Bank Credit Commitments to Developing Countries, 1979-First Half 1985

(In billions of U.S. dollars)

	1979 1/	1980 1/	1981	1982	1983	1984 2/	1984 1st Half	1984 2nd Half 2/	1985 1st Half 3/
Developing countries	50.9	38.3	48.1	44.6	34.9	31.0	18.0	13.0	9.3
Capital-importing	49.8	37.8	47.0	42.6	32.6	29.9	17.6	12.3	8.7
Africa	4.8	2.6	4.1	2.7	2.7	0.5	0.3	0.2	1.1
Spontaneous lending 4/	(4.8)	(2.6)	(4.1)	(2.7)	(2.7)	(0.5)	(0.3)	(0.2)	(1.0)
Concerted lending 4/	(...)	(...)	(...)	(...)	(--)	(--)	(--)	(--)	(0.1)
Asia	11.0	9.2	12.8	12.6	10.4	10.2	4.6	5.6	2.9
Spontaneous lending 4/	(11.0)	(9.2)	(12.8)	(12.6)	(10.4)	(9.3)	(4.6)	(4.7)	(2.9)
Concerted lending 4/	(...)	(...)	(...)	(...)	(--)	(0.9)	(--)	(0.9)	(--)
Europe	7.8	4.9	4.7	3.7	3.5	3.4	1.2	2.2	2.3
Spontaneous lending 4/	(7.8)	(4.9)	(4.7)	(3.7)	(2.9)	(3.4)	(1.2)	(2.2)	(2.3)
Concerted lending 4/	(...)	(...)	(...)	(...)	(0.6)	(--)	(--)	(--)	(--)
Middle East	0.2	0.7	0.2	0.6	0.7	0.4	0.1	0.3	--
Western Hemisphere	26.0	20.4	25.2	23.0	15.3	15.4	11.4	4.0	2.4
Spontaneous lending 4/	(26.0)	(20.4)	(25.2)	(23.0)	(2.0)	(0.6)	(0.3)	(0.3)	(0.2)
Concerted lending 4/	(...)	(...)	(...)	(...)	(13.3) 5/	(14.8)	(11.1)	(3.7)	(2.2)

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

1/ Includes only Eurocredit commitments.

2/ Includes agreements in principle with Argentina and the Philippines, and excludes the short-term trade deposit facility for Argentina of $0.5 billion.

3/ Includes agreements in principle with Chile and Colombia.

4/ Concerted lending refers to bank credit commitments obtained in 1983-85 and coordinated by a bank advisory committee (i.e., Argentina, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Panama, Peru, the Philippines, Uruguay, and Yugoslavia).

5/ Excludes the extension of a bridging loan of $1.3 billion to Agentina.

Table V. Short-Term Claims 1/ in
Percent of Outstanding Bank Claims, 1979-84

(In percent)

	Dec. 1979	Dec. 1980	Dec. 1981	Dec. 1982	Dec. 1983	Dec. 1984
All countries	43.9	45.5	47.1	46.7	46.0	41.3
Industrial countries (other than Group of Ten and Switzerland, Austria, Denmark, and Ireland)	41.4	43.0	44.0	43.7	44.6	44.7
Developing countries	44.9	47.0	48.1	48.0	47.0	40.9
Capital-importing	43.4	45.4	46.3	46.2	44.8	40.6
Africa	28.9	28.9	35.8	39.4	41.4	43.2
Asia	52.4	55.2	53.9	51.6	50.6	55.2
Of which:						
Indonesia	39.7	41.3	41.7	38.4	37.7	41.9
Korea	55.8	62.3	57.8	60.0	58.2	49.8
Philippines	52.7	58.1	56.9	60.0	55.3	53.2
Europe	37.6	36.2	34.4	32.4	34.5	33.3
Middle East	75.2	76.5	77.9	77.6	77.2	65.9
Western Hemisphere	43.0	46.1	46.5	46.0	42.8	34.6
Of which:						
Argentina	51.5	52.3	46.8	54.3	52.4	55.0
Brazil	29.3	35.4	34.7	34.9	30.6	25.0
Mexico	34.6	44.2	48.7	47.6	43.4	24.1
Venezuela	61.1	58.9	61.5	57.5	59.2	65.4
Centrally planned economies 2/	41.0	38.4	43.1	39.2	38.8	38.5

Source: Bank for International Settlements, The Maturity Distribution of International Bank Lending.

1/ Remaining maturity of one year or less.
2/ Excluding Fund member countries.

Table VI. Undisbursed Credit Commitments in
Percent of Outstanding Bank Claims, 1979-84

(In percent)

	Dec. 1979	Dec. 1980	Dec. 1981	Dec. 1982	Dec. 1983	Dec. 1984
All countries	24.7	23.4	21.0	17.2	16.8	15.3
Industrial countries (other than Group of Ten and Switzerland, Austria, Denmark, and Ireland)	22.0	31.1	31.8	29.9	29.2	25.9
Developing countries	26.1	23.2	20.5	18.0	14.7	13.7
Capital-importing	26.1	23.2	20.1	14.8	13.9	12.7
Africa	32.8	30.7	27.6	25.7	21.3	20.6
Asia	44.7	38.8	37.5	27.4	24.6	25.1
Of which:						
Indonesia	36.2	34.9	36.1	22.2	24.6	27.9
Korea	33.3	25.8	20.6	16.8	13.2	17.0
Philippines	39.2	25.8	27.5	19.1	12.1	8.1
Europe	19.7	20.0	14.9	12.8	10.4	11.7
Middle East	24.8	20.6	17.2	14.8	13.9	21.5
Western Hemipshere	20.2	17.5	14.4	8.4	9.0	5.9
Of which:						
Argentina	21.6	20.1	15.7	7.4	6.6	7.6
Brazil	17.4	14.0	11.6	8.8	7.1	5.5
Mexico	19.7	15.8	12.8	5.9	12.4	4.8
Venezuela	19.7	15.2	12.2	8.7	3.3	3.4
Centrally planned economies 1/	18.9	16.5	12.6	14.7	17.9	11.2

Source: Bank for International Settlements, The Maturity Distribution of International Bank Lending.

1/ Excluding Fund member countries.

Table VII. Terms on New Publicized Long-Term International Bank Credit Commitments, 1979-First Half 1985

(In percent, unless otherwise indicated)

	1979	1980	1981	1982	1983	1984 1/	1984 First Half	1984 Second Half 1/	1985 First Half 2/
Six-month Eurodollar interbank rate (average)	11.90	13.91	16.69	13.60	9.92	11.29	11.25	11.33	9.03
U.S. prime rate (average)	12.66	15.26	18.87	14.86	10.79	12.13	11.69	12.56	10.48
Average maturity (in years/months)	8/8	7/9	7/8	7/7	7/3	7/9	8/5	7/4	7/7
OECD countries	8/11	8/0	7/8	8/3	7/8	7/4	7/8	7/4	7/7
Centrally planned economies	8/0	6/7	5/7	4/9	4/5	5/11	5/5	6/2	6/10
Oil-exporting countries	8/0	7/3	7/9	6/0	7/2	7/7	7/6	7/8	7/6
Other developing countries	8/8	7/8	7/9	7/0	7/0	8/11	9/2	7/10	8/2
Average spread	0.79	0.74	0.80	0.77	1.15	0.93	1.23	0.60	0.51
OECD countries	0.62	0.59	0.58	0.56	0.65	0.55	0.68	0.48	0.42
Centrally planned economies	0.70	0.88	0.62	1.03	1.18	0.88	0.72	0.94	0.55
Oil exporting countries	1.05	0.77	0.79	0.94	0.85	0.76	0.71	0.80	0.63
Other developing countries	0.85	0.91	1.04	1.14	1.70	1.44	1.60	0.64	0.69

Sources: Organization for Economic Cooperation and Development, Financial Market Trends; International Monetary Fund, International Financial Statistics (for Eurodollar rate); Federal Reserve Bulletin (for prime rate); and unpublished data from the Organization of Economic Cooperation and Development (for details on maturities).

1/ Does not include terms of agreements in principle with Argentina and the Philippines.
2/ Does not include terms of agreements in principle with Chile and Colombia.

Table VIII. Change in Bank Claims on Developing Countries from Different Data Sources, 1982-84 1/

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

	1982		1983		1984	
	Billions of U.S. dollars	Growth rate (In percent)	Billions of U.S. dollars	Growth rate (In percent)	Billions of U.S. dollars	Growth rate (In percent)
Developing countries						
BIS semiannual	38.7	10.1	26.0	6.2	1.3	0.3
U.S. claims data	12.7	9.9	6.4	4.5	-3.3	-2.2
U.K. claims data	6.1	10.9	2.5	4.0	-0.7	-1.2
Capital-importing						
BIS semiannual	37.6	10.4	21.7	5.4	3.3	0.8
U.S. claims data	12.7	10.3	5.9	4.3	-2.6	-1.8
U.K. claims data	5.9	11.5	2.1	3.6	--	--
Africa						
BIS semiannual	5.6	12.8	3.2	6.5	0.1	0.2
U.S. claims data	1.4	15.9	1.0	9.7	-0.9	-7.9
U.K. claims data	2.8	33.6	0.5	4.7	-0.1	-1.2
Asia						
BIS semiannual	10.6	17.5	8.7	12.2	4.7	5.9
U.S. claims data	3.5	13.2	1.6	5.2	-3.1	-10.0
U.K. claims data	1.4	16.5	0.4	3.6	-0.3	-3.0
Europe						
BIS semiannual	-0.3	-0.7	1.6	3.5	0.8	1.7
U.S. claims data	-0.8	-7.0	0.9	9.5	-0.4	-3.6
U.K. claims data	-0.2	-2.7	0.2	3.2	-0.2	-2.5
Middle East						
BIS semiannual	3.3	20.3	0.6	3.1	-0.2	-1.5
U.S. claims data	0.2	7.1	0.3	8.9	-0.3	-8.4
U.K. claims data	0.3	23.4	-0.1	-3.5	-0.2	-11.6
Western Hemisphere						
BIS semiannual	18.4	9.4	7.6	3.6	4.4	2.0
U.S. claims data	8.3	11.2	2.1	2.6	2.2	2.5
U.K. claims data	1.6	6.0	1.1	3.8	0.8	2.9

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

1/ This data is not adjusted for the impact of exchange rate movements, and is based on consolidated reports of banks.

Table IX. Capital-Asset Ratios of Banks in Selected Industrial Countries, 1977-84 1/

(In percent)

	1977	1978	1979	1980	1981	1982	1983	1984
Canada 2/	3.40	3.27	3.16	2.98	3.46 3/	3.65	4.06	4.43
France 4/	...	2.29	2.62	2.40	2.20	2.07	1.96	1.94
Germany, Federal Republic of 5/	3.41	3.32	3.31	3.27	3.26	3.31	3.34	3.38
Japan 6/	5.28	5.12	5.13	5.28	5.25	5.03	5.22	5.15
Luxembourg 7/	...	...	...	3.52	3.45	3.50	3.59	3.83
Netherlands 8/	4.41	3.86	4.29	4.20	4.33	4.60	4.68	4.72
Switzerland 9/								
Largest 5 banks	6.09	6.20	6.11	6.18	5.78	5.58	5.44	5.29
All banks	5.59	5.68	5.63	5.66	5.36	5.25	5.16	5.05
United Kingdom								
Largest 4 banks 10/	7.14	7.53	7.18	6.85	6.39	6.28	6.59	6.20
All banks 11/	5.20	5.20	5.10	5.00	4.47	4.14	4.35	4.47
United States								
Nine money center banks 12/	4.95	4.73	4.51	4.52	4.62	4.93	5.41	6.22
Next 15 banks 12/	5.72	5.42	5.37	5.51	5.21	5.34	5.69	6.63
All country reporting banks 12/13/	5.70	5.53	5.29	5.35	5.38	5.60	5.94	6.53

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

1/ Given the problems of consistency across banks and over time in the accounting of bank assets and capital, aggregate figures such as the ones in this table must be interpreted with caution.

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

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

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

5/ Ratio of capital including published reserves to total assets (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 1984 would show a ratio of 6.98 percent. Inclusion of current-year profits in banks' capital resources would result in a weighted average of 4.03 percent for 1984. Provisions for country risks, which are excluded from capital resources, have been considerably increased in the last four years, with a tripling of the level of provisions between 1982 and 1984.

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 reserves 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 includes equity, subordinated debentures, and reserves for loan losses, to total assets.

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