Prime Minister's
Duty Clerk
27/8

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

27 August 1982

F.E.R. Butler, Esq.,
No.10 Downing Street

Dear Robin,

SEMINAR ON THE INTERNATIONAL BANKING SCENE

As agreed, I am attaching three background papers in advance of the Prime Minister's seminar on Wednesday.

The first is a paper prepared by the Bank of England, in response to the Prime Minister's request for an assessment of the financial standing of various Latin American countries and the implications for the banking system. We had been intending to process this further, but given next week's meeting it seemed sensible to send it to you now, particularly as the four largest LDC borrowers from BIS banks are Latin American countries. The section on pages 4-6 deals with the implications for the international banking community, and British owned banks in particular. Short assessments follow of prospects for each of the main Latin American borrowers.

The second paper is a compilation of available statistics on the world-wide exposure of the international banking system and of British banks. This is of course only part of the picture, since international business accounts for less than 15 per cent of the world banking system's assets. But there are no available statistics on international banks' aggregate domestic exposure, for example to particular problem industries or corporations.

This note also describes the two most important aspects of the co-operative international arrangements built up since the banking failures in 1974 by the central banks and banking supervisory bodies of G10 countries and Switzerland - both for improving the supervision of international banking business, and for dealing with any problems that arise.

/The third

The third paper shows our exposure to "problem" countries on official (ECGD covered) debt. These figures are on a different basis from the banking statistics; there is also some overlap between the two since bank lending covered by official export credit agencies is also included in the banking figures.

I am copying this letter and its enclosures to the Private Secretary to the Governor, and to Alan Walters.

Yours ever,

John Kerr.

J.O. KERR

LATIN AMERICA: AN ASSESSMENT OF THE FINANCIAL STANDING OF COUNTRIES IN THE REGION AND THE IMPLICATIONS FOR THE BANKING SYSTEM

CONTENTS

BANK OF ENGLAND

August 1982

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GENERAL ASSESSMENT

A PROBLEMS OF MAJOR LATIN AMERICAN BORROWING COUNTRIES

The focus of this paper is on Mexico, Brazil, Argentina, Venezuela and Chile, which together account for some four-fifths of the external debt of Latin America and the Caribbean which is estimated to be approaching US$300 bn.? In doing this, it is not the intention to underrate the serious difficulties in which a number of other countries in the region find themselves; Bolivia, Costa Rica, Guyana and Honduras are all currently involved in debt rescheduling exercises, but in those cases the magnitudes are not such as to offer a threat to the fabric of the international financial system, nor are they likely of themselves to give rise to a serious knock-on effect on other countries in Latin America, although in present circumstances the psychological impact of any further failure needs careful watching.

Attached to this general assessment are individual pieces on the five major borrowing countries referred to above together with three statistical tables. While the high external debt borne by each country shares some common origins with the others (notably the ability and need to raise readily available - if sometimes expensive - credits on the international market for development purposes) and some common characteristics (notably the recent growth both of private sector and short-term debt), it would also be true to say that each country has arrived at the difficult position it now finds itself in by significantly different routes. A distinction can be made, for example, between those of the five which are oil producers - Mexico, Venezuela and Argentina - and Brazil and Chile, which are net importers of oil. This contrast is at its sharpest between Mexico and Venezuela, which have failed, or at least have not yet succeeded in turning their substantial oil wealth to their long-term economic advantage, and Brazil, which has developed a highly diversified productive and exporting capacity while oil constitutes a major part of its import bill. Despite these fundamental differences, all have built up substantial indebtedness on the international market. The level of this external debt can be said to be sustainable only so long as economic policies remain reasonably consistent and respond sufficiently quickly to changes in circumstances both at home and abroad.

The view over the next twelve months indicates that of the five countries under review, only Venezuela (by dint of its cushion of foreign exchange reserves) and, with a lesser degree of confidence, Chile (by virtue of strict policies allied to current negotiations on an IMF programme) can be said to be likely to avoid trouble, but policies conducted in both countries have not been entirely risk free. The size of Venezuela's debt has been contributed to by uncontrolled short-term borrowings in recent years by public sector agencies. The foreign exchange difficulties of Chile are a reflection of a stubborn refusal between 1979 and June of this year to abandon a fixed exchange rate policy which left the peso seriously overvalued. Argentina's wounds are almost habitually self-inflicted. With near self-sufficiency in oil, exportable surpluses of basic foodstuffs and low population growth, Argentina's economy has possibly the soundest potential of any country in Latin America. But the size of the public sector, much of it under the control of the freely spending armed forces, and the volatile nature of the people reduce the opportunities for coherent and effective policy-making. Since before the Falklands invasion it was clear that Argentina would have to enter into some form of rescheduling exercise with its creditors and this is even more necessary now. The volatility of the political situation there makes that country the most likely one of the five which might risk repudiating its external debt, but this still must be considered to be unlikely provided negotiations on a debt restructuring can get under way soon with the banks. Brazil's efforts, especially since end-1980, to cope with its huge external debt service have been impressive. Economic policy is in firm hands and the authorities have shown themselves willing to pay the margins necessary to raise the money needed in the international market. This year, however, Brazil's debt service obligations may be more difficult to meet, reflecting both the impact on the country's export earnings potential of the prolonged world recession and the premature relaxation of economic policy during an important election year for the military government.

For Mexico the crisis has already broken and an international rescue operation, involving central bank assistance to help the country meet its immediate obligations, is currently under negotiation. It is the speed with which Mexico's difficulties have developed which provide the major lesson to be learnt by both the Mexican authorities and her international creditors. In June 1981 the thought of Mexico finding itself within the next 14 months to be unable to generate the necessary finance to meet its obligations was inconceivable. Serious economic mismanagement, constrained by political considerations and characterised by a reluctance to recognise and face up to the realities of a fast deteriorating set of circumstances has been revealed by policy measures over the past (election) year, which have been inadequate, inconsistent, and taken too late. Even the new, highly respected, economic team has recently been forced to adopt measures to protect the reserves (including a three-tier exchange rate and exchange controls) which can hardly be expected to restore confidence either within Mexico or abroad.

A question which has to be addressed is to what extent the crisis in which, for example, Mexico finds itself is likely to have a 'knock-on' effect on any of the other countries under review, say Brazil. The answer to which this paper lends support is that such an effect is unlikely to be so specific, although it is inevitable that attention to a bloc of countries is likely to be drawn by difficulties in one of them. Looking back to 1980, worries about Brazil showed signs of affecting sentiment towards the area as a whole, but this concern gradually ebbed as Brazil's fortunes improved and attention moved towards developments in Eastern Europe. However, by the beginning of this year again, mounting economic difficulties in Latin America had led to an awareness in the banking community of the need to re-assess both its willingness to lend to much of the region and the terms attached to new borrowings. The Falklands crisis sharpened this focus, but it would be wrong to see any causative link between that and the circumstances of Mexico today, the origins of which were already well in train by the end of 1981. Together, however, the two events have reinforced what was already becoming a cautious attitude toward lending to Latin America on the part of the commercial banks.

B IMPLICATIONS FOR THE BANKING SYSTEM

Total lending by the international banking community to the non-OPEC developing countries, which includes Mexico, represents just over 5% of its total assets which is substantial and larger than its own total capital but relatively modest by comparison with its total loans. Loans to Brazil and Mexico each represent about 1% of total assets. Experience to date suggests that the banks have managed restructuring of debts in a fairly orderly way so that debt service difficulties by some of the largest developing country borrowers need not of themselves pose a major threat to the international banking system. The banks are better supervised than they were 10 years ago and risks are more diversified among more participants. However, there is no doubt that the size and structure of debt built up by some countries since the first oil shock is causing considerable concern in the credit markets and tending to make lending banks much more conservative. Some of the big borrowers are finding it hard - perhaps impossible - to maintain the flow of new capital. If Mexico and then Brazil are forced by a cash flow crisis to reschedule - assuming that Argentina cannot avoid it - the volume of questionable debt will reach well over $200 bn - although not all of it is to banks. This is several times larger than experience to date, but provided that some debt service is maintained - especially of interest - on the rescheduled amounts, orders of this magnitude might be manageable. It would admittedly be painful: the quality of some of the banks' assets would be impaired; their earnings might be quite severely affected in the short run if arrears on interest and capital began to build up; confidence in those banks believed by the market to be heavily exposed to problem countries could be affected.

There is, however, a risk of second order effects if the lending banks decide that the creditworthiness of all developing countries, including those outside Latin America, is no longer high enough to justify further lending. This would extend the cash flow problem to other countries and so enlarge the proportion of debts that had to be rescheduled. Of course a significant proportion of all of the debts in question would have official guarantees from bodies like ECGD, and rescheduling of official loans would therefore also be entailed. The consequences for the borrowers would be severe enforced adjustment.

It is possible that a few of them would prefer the odium of outright repudiation of debt to the domestic and political cost of the adjustment needed to maintain the debt service. This would lead to outright losses by the banks. However, most borrowers are probably fully aware that the long-term cost to their creditworthiness of such drastic action would outweigh the short run gain; many of the larger borrowers are also creditors themselves having developed export credit facilities to support their own newly emerging industries.

Even if the debt service difficulties of the developing countries did lead to major outright losses, these too could probably be absorbed in most cases by the banks, albeit with a nasty jolt, although the seriousness of the impact would depend also on the banks' loss experience with their domestic loan portfolio. Although exposure is better diversified than it used to be its distribution is still uneven. The banks with the largest exposure to Latin America are the big American international banks who are similarly at risk in relation to some large US corporations. There is thus a possibility that a combination of unfavourable events in Latin America and in the US domestic market could in the worst case threaten the solvency of some of them. There would then be a serious danger of a crisis of confidence from which the London market would not be immune and which could only be averted by official intervention. The resumption of lending by the private markets to Hungary has already shown that leadership from the authorities can help to restore financing flows.

Total lending by British owned banks to Latin America amounts to some $17 bn. All the major British banks have substantial exposure to the region. The scale of this exposure and its potential seriousness if some of it were to crystallise as bad debts is illustrated by the fact that for three important banks their theoretical exposure exceeds their capital. There is no reason to suppose that British banks are more at risk than their counterparts in other countries. Compared with some foreign banks, the general quality of the major British banks' assets is high. In addition the relative strength of their earnings and capital position is such that they should be better placed to withstand losses and to retain the confidence of depositors. Nevertheless, some of the smaller banks in London, particularly those which have tended to specialise in

Latin American lending may be more vulnerable both to actual losses and to pressure on their liquidity.

In conclusion, the most probable outcome, of debt service difficulties in Latin America would be some impairment of the profitability of international banks, some slowing down of the rate of new credit to other developing country borrowers and greater discrimination between different credit risks both by price and amount. This might in itself be no bad thing and by making the banks more choosy help reinforce the role of the IMF in assisting adjustment by providing conditional liquidity to borrowers. Their creditworthiness would also be enhanced by a sustained reduction in US interest rates which would not only reduce their debt service burden, but also contribute to economic recovery in the global economy.

ARGENTINA

		1981	Forecast 1982
1	Total Debt ($bn):	35.7	37.3
2	O/w Public Sector:	20.2	21.1
3	British Banks' consolidated claims ($bn):	2.7	
4	Debt Service Ratio (%):	58.1	82.1
5	Financing Requirement ($bn) (= Current account + medium & long-term debt amortization)	7.4	7.2

The significant increase in external debt from $8¼ bn in 1976 to $35¾ bn (56% of which owed by the public sector) at end-1981 was facilitated by relative economic and political stability in Argentina over most of the period. In latter years, however, growing uncertainties on both these fronts have progressively reduced the country's ability to increase its debt and forced both public and private sectors to rely heavily on short-term borrowings, which accounted for nearly 30% of debt at the end of last year. Following the Falklands crisis the growth in external debt has come virtually to a standstill.

The country's total debt servicing burden (including short-term maturities) in the second half of this year is officially put at $15 b compared with an original unofficial estimate of $19 bn due in the whole of 1982. The bunching of repayments reflects additional maturities of rolled over short-term credits - effectively the only type of financing available since the imposition of the UK asset freeze in April. There is a strong likelihood that the Argentines may not be able to meet a sizeable portion of these commitments as the expected trade surplus in the second half of the year (after peak seasonal grain exports have finished) will be insignificant by comparison and only a fraction of international reserves are reported to be quickly available. Already, by end-June, $2¼ bn in capital repayments were overdue and interest payments reportedly running up to a month late.

Despite the precariousness of the country's external financial positio the new Bignone regime has been forced, in the interests of political stability, to substitute reflationary policies for the strict monetary orthodoxy espoused by former Finance Minister Alemann. Measures, which include a large devaluation of the peso, general wage increases [illegible] and interest rate ceilings, have led to apprehension that a wage/price spiral reminiscent of the Peronist period in the mid-1970s will develop. According to unofficial forecasts, year-on-year inflation could accelerate to over 200% by the end of the year from around 140% now.

At the same time, the Argentines, who sent a mission to New York early in August for preliminary discussions with commercial bank creditors, are seeking fresh funds and a renegotiation of existing debt in a way that falls short of a formal rescheduling. However, international banks are unlikely to be accommodating while UK/Argentine sanctions remain in force; and even once these are lifted, a major rescheduling appears inevitable in view of the rapid deterioration in Argentina's creditworthiness, which has been exacerbated by concern over the country's uncertain political situation and the new economic policies. Meanwhile the markets are concerned over reports of a growing lobby in Argentina favouring debt repudiation.

BRAZIL

	1981	Forecast 1982
Total Debt ($bn):	69.4	81.0
2 O/w Public Sector:	47.2(est)	53.5
3 British Banks' consolidated claims ($bn):	4.3	
4 Debt Service Ratio (%):	66.9	73.2
5 Financing Requirement ($bn): (= Current account + medium & long-term debt amortisation)	19.4	20.4

Dependence on imported petroleum and a policy of deferred adjustment in the years following the first oil shock lie behind the rapid accumulation of foreign debt, which rose from under $13 bn in 1973 to around $70 bn at end-1981. Of this over 65% is accounted for by the public sector, although its share has tended to diminish in recent years as the authorities have encouraged private sector borrowing by, for example, exempting foreign currency financed bank lending from credit ceilings. In contrast with other large borrowers in the region, Brazil has successfully limited the increase in short-term debt which represents only around 12% of the total.

Steep rises in the cost of servicing the external debt have become an increasing constraint which the authorities have sought to alleviate by boosting exports and continued large scale borrowing. This year, however, Brazil may experience difficulty in covering debt service commitments* of some $18½ bn given the government's apparent inability to consolidate last year's progress in reducing inflation and the current account deficit, and the negative impact this is beginning to have on market sentiment.

With national elections due in November, the authorities have sought a premature relaxation of the tight economic policy pursued since late 1980, in order to lead the country out of its worst recession in recent history. However, many of the prospective benefits to the business community have been slow to materialise. The reason lies mainly in the failure to control public expenditure which has necessitated increased taxes, successive rises in administered prices and higher interest rates. Reflecting these developments,

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* ie payments of interest and principal on medium and long-term debt and of interest on short-term debt.

year-on-year inflation, after falling steadily from a peak of over 120% in April 198[illegible] to 91% in May 1982, has reaccelerated to almost 100% in July.

Contrary to orginal official projections for a further improvement in the current account deficit this year to around $10½ bn, from almost $13 bn in 1981, a deterioration to over $13 bn appears probable in the light of poor export earnings, which could fall by up to 10% this year. This not only reflects the impact of world recession, which has led to weak commodity prices and a sharp contraction in Brazil's most important markets for manufactured exports, but also worsening competitiveness as the authorities have resorted to an over-valued exchange rate in an attempt to limit inflationary pressures. The government has recently revised down the expected trade surplus for the year from $3 bn to $1½ bn, similar to last year's outturn. Inthe absence of a trade improvement, the projected current account deterioration is largely attributable to higher net interest payments.

There is concern in the markets that, with banks approaching their country limits for Brazil in addition to exercising more caution in lending to Latin America generally, the country may experience difficulty in raising the higher than expected balance of funds (some $4-5 bn) needed to complete this year's borrowing programme. Already there are indications that spreads on medium term credits, having remained steady for a year now at around 2⅛%, may be coming under pressure. Present uncertainty over Brazil's prospects is reinforced by rumours of a growing lobby for the replacement of Planning Minister Delfim Neto - a key figure behind the country's economic progress in recent years and held in high regard by the international banking community. A consistent opponent to calls at home for a rescheduling of the external debt, his replacement could spark a major crisis.

		1981	1982
1	Total Debt ($bn):	14.5	17.5
2	O/w Public Sector:	4.5	6.0
3	British Banks' consolidated claims ($bn):	0.9	
4	Debt Service Ratio (%):	41.0	50.0
5	Financing Requirement ($bn): (= Current account + medium & long-term debt amortization)	5.9	4.0

Post-Allende economic policies have stressed the pre-eminence of the private sector in the economy. Since public sector finances have been in balance and monetary policy was effectively neutral, the bulk of financing the widening current account deficit has fallen on the private sector. As a result private sector debt has increased from $0.4 bn out of a total debt of $3.3 bn in 1973 to $10.0 bn in 1981. Not surprisingly given the increase in private sector debt, two thirds of total debt is owed to international banks. Whereas public debt service (interest and amortization) has changed little in recent years ($0.9 bn in 1981 compared to $0.8 bn in 1977), private sector debt servicing has risen to $1.6 bn in 1981 from $1.1 bn in 1977 and, on existing debt, is likely to average about $2.0 bn pa until the mid-1980s.

The most notable success of Chilean policy has been in the battle against inflation. However, with its open economy characterised by low tariffs and an overvalued currency, Chile has not escaped the full brunt of recession over the last year or so. This has resulted in a record number of bankruptcies which threaten the stability of the financial system. Chilean banks' heavy exposure to the international financial system has forced the authorities to react quickly to maintain confidence by closing down a number of (small) unviable institutions as well as to take measures to alleviate the effects of banks' large overdue loan portfolios. Finally, the authorities were also forced to devalue the peso in June after maintaining a fixed parity for 3 years.

The recession will, however, lead to a narrowing of the current accoun deficit during 1982, thus substantially reducing the country's financi requirement and slowing down the increase in the stock of external deb

There has, nevertheless, been some market resistance to Chilean borrowers in recent months (also affected by the Falklands crisis) with spreads on public sector borrowings reaching LIBOR + $1\frac{1}{4}/1\frac{3}{8}$% compared with +$\frac{7}{8}$/1% at the beginning of the year. Private sector borrowings have been raised at +$1\frac{1}{8}$% earlier in the year but have been scarce of late. However, the general record of good economic management, the high level of reserves ($2.8 bn at end-June), and expected backing from the IMF to the tune of SDR 0.7 bn over the next year and a half should help to alleviate problems in the short-term.

outflows remained unchecked despite a substantial depreciation of the peso from February of this year. The emergence of debt servicing difficulties in the private sector and in particular those of the large industrial conglomerate, Grupo Alfa, which came to the fore this year, were a further blow to international confidence. At a market level, therefore, the deterioration in credit worthiness led to an appreciable rise in spreads. A \$2½ bn jumbo loan in June earned margins of 1% and 1½% over LIBOR (or ¾% and 1⅛% over the US prime rate) whilst a euro-dollar note issue last month carried a record interest rate of 18½%.

MEXICO

	1981	Forecast 1982
1 Total Debt ($bn):	72.0	88.0
2 O/w Public Sector:	53.0	64.0
3 British Banks' consolidated claims ($bn):	5.7	
4 Debt Service Ratio (%):	50.0	66.0
5 Financing Requirement ($bn): (= Current Account + medium & long-term debt amortization)	19.7	18.9

Mexico's acute socio-economic pressures and the low level of domestic savings have led to a rapid build-up in external indebtedness to finance the government's ambitious development plans. The stock of medium and long-term public external debt rose from $3.5 bn at the beginning of 1972 to $42.2 bn in 1981. Public debt servicing rose from less than $1.0 bn in 1972 to over $9.5 bn last year. Moreover, the stock of private debt also increased rapidly, to some $20 bn at end-1981. International banks account for nearly 90% of Mexico's total debt.

The accumulation of the largest LDC debt and the particularly large public sector external borrowing requirement ($27 - 28 bn gross; $11 bn net in 1982) in themselves have presented formidable constraints These were exacerbated by the emergence of the world oil surplus during 1981, and excess demand pressures in the economy which presented serious threats to the Mexican authorities' oil-led growth strategy. In order to finance the substantial increase in the deficits on current account and in public sector finances, the authorities also found it increasingly necessary to resort to short-term funding with the result that public short-term debt rose from $1.5 bn in 1980 to $10.8 bn in 1981.

Confidence in the authorities' ability to deal effectively with these problems was further undermined by the virtual interregnum which exists in an election year making consistent policy-making difficult. Speculation against the peso grew and heavy capital

VENEZUELA

		1981	Forecast 1982
1	Total Debt ($bn):	26.0	28.0
2	O/w Public Sector:	18.9	20.0
3	British Banks' consolidated claims ($bn)	2.5	
4	Debt Service Ratio (%):	18.0	27.0
5	Financing Requirement ($bn): (= Current account + medium & long-term debt amortization)	-1.4	4.0

The oil price increases in 1973-74 enabled the authorities to embark on an ambitious investment programme to diversify the productive base of the economy away from oil. However, this expansion was not well managed and was marked by public sector profligacy and waste. A number of large scale unproductive projects were embarked upon while agricultural self sufficiency was eroded. Thus, while the total stock of medium and long-term public debt had risen only very slowly up to the mid-1970s, the government spending programme led the authorities to make significant recourse to the euromarkets for finance from 1975 onwards.

Given Venezuela's oil wealth, the debt service ratio of about 11% on public medium and long-term debt during the second half of the 1970s was quite acceptable. However, increasingly during this period, decentralised agencies and state enterprises circumvented external debt regulations as well as their own budgetary constraints by borrowing short-term. Thus, the public sector's short-term external debt rose rapidly and exceeded $10 bn at end-1980. During the second half of 1981 and throughout this year, the authorities have attempted to rationalise and restructure short-term public debt. This met with some success during 1981 when end-year public short-term debt fell below $9½ bn. However, restructuring plans during this year have been hampered by the Venezuelans' refusal to pay higher spreads (ie more than LIBOR + ¾% for 8-year money) on their euro-borrowings, leading notably to the cancellation of an intended $2 bn credit. The Venezuelans were quick to accuse HMG and the Bank of England of sabotaging the loan (as negotiations with banks occurred during the Falklands dispute in which Venezuela strongly supported the Argentines).

In truth, however, the US and Japanese banks (there were no UK banks involved) were justified in seeking higher margins in view of a perceived greater credit risk brought about by the loss in oil revenues which could amount to some $5-6 bn this year.

The Venezuelan debt situation can thus be characterised as messy rather than a serious constraint on the balance of payments - which has been running a substantial surplus on current account in the last two years and which has enabled the authorities to accumulate foreign exchange (including Central Bank) reserves of some $18 bn at end-1981. However, the economy is susceptible to capital outflows (Central Bank reserves fell by $1.4 bn in the first quarter of this year during a period of speculation against the Bolivar) and to the world price of oil. Venezuela's total (all maturities) end-1981 debt of about $26 bn ($19 bn public, $7 bn private) is not large in absolute terms by other Latin American standards (though it represents some 38% of GDP) but it could well emerge as a constraint if excess demand pressures are allowed to appear during the run-up to elections next year or if oil revenues remain depressed beyond the short-term.

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NKING CLAIMS ON LATIN AMERICAN AND CARIBBEAN COUNTRIES AT END-DECEMBER 1981

billions)

	BIS reporting area banks' claims	UK banks' £ and fc claims	UK-registered banks' consolidated claims		British banks' consolidated claims		American banks' consolidated claims (end-June 1981)	West German banks' consolidated claims
			Total	Total net of outward risk transfer	Total	Total net of outward risk transfer		
entina	22.9	6.0	3.6	3.3	2.7	2.3	7.5	1.3
bados	0.1	0.05	0.03	0.02	0.03	0.02	–	–
ivia	0.9	0.2	0.2	0.2	0.1	0.08	0.5	0.1
zil	49.7	11.2	6.7	5.8	4.3	3.5	15.2	2.8
le	9.6	2.0	1.6	1.5	0.9	0.9	4.7	0.5
ombia	4.9	0.8	0.6	0.5	0.4	0.3	2.6	0.2
ta Rica	0.8	0.2	0.2	0.2	0.1	0.1	0.6	–
a	1.4	0.3	0.2	0.2	0.08	0.06	–	–
inican Republic	0.5	0.1	0.05	0.05	–	–	0.5	–
ador	4.1	0.8	0.7	0.7	0.5	0.5	1.9	0.8
Salvador	0.2	0.02	0.01	0.01	–	–	0.1	–
nada	–	–	–	–	–	–	–	–
temala	0.4	0.06	0.05	0.05	0.01	0.01	0.2	–
ana	0.1	0.07	0.03	–	0.03	0.01	–	–
ti	0.04	–	–	–	–	–	–	–
luras	0.4	0.07	0.1	0.1	0.1	0.1	0.2	–
ica	0.5	0.08	0.1	0.03	0.03	0.02	0.2	–
co	55.3	13.1	8.1	7.2	5.7	5.2	18.1	1.6
ragua	0.5	0.05	0.09	0.08	0.06	0.05	0.4	–
ma	25.6	6.0	2.4	1.2	1.9	0.8	5.1	0.8
guay	0.4	0.1	0.04	0.04	0.04	0.04	0.2	0.08
a	4.3	0.8	0.7	0.6	0.4	0.3	1.8	0.08
name	0.08	0.06	–	–	–	–	–	–
idad & Tobago	0.6	0.2	0.1	0.1	0.08	0.07	0.1	–
uay	0.9	0.3	0.3	0.3	0.2	0.2	0.4	0.03
zuela	22.3	5.1	3.2	3.1	2.5	2.4	10.0	1.6

TOTAL (PUBLIC AND PRIVATE) DISBURSED DEBT AT END-DECEMBER 19[illegible], 1981 AND FORECAST FOR 19[illegible]

$ billions

		DISBURSED DEBT		
		1980	1981	Forecast 1982
MEXICO	medium/long-term	n/a	49.2	66.0
	short-term	n/a	22.8	22.0
	Total	46.8	72.0	88.0
BRAZIL	medium/long-term	53.8	61.4	72.0
	short-term	7.0	8.0	9.0
	Total	60.8	69.4	81.0
ARGENTINA	medium/long-term*	16.8	26.0	
	short-term*	10.4	9.7	
	Total	27.2	35.7	37.3
VENEZUELA	medium/long-term*	13.0	15.0	18.0
	short-term*	12.0	11.0	10.0
	Total	25.0	26.0	28.0
CHILE	medium/long-term*	9.5	12.5	15.0
	short-term*	1.2	2.0	2.5
	Total	10.7	14.5	17.5
		170.5	217.6	251.8

*These maturity breakdowns are partially estimated.

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...RVICE, DEBT PATIOS AND FINANCING REQUIREMENTS

	Debt Service*			Debt Ratios												Financing Requirements ($bı		
	$ billions			Debt Service Ratio ≠			Debt service as a % of GDP			Disbursed debt as a % of exports of goods & services			Disbursed debt as a % of GDP			= current a/c deficit + amortisation of medium/long-term debt		
	1980	1981	Forecast 1982	1980	1981	Forecast 1982	1980	1981	Forecast 1982	1980	1981	Forecast 1982	1980	1981	Forecast 1982	1980	1981	Forecast 1982
..XICO	10.1	15.0	20.0	41.0	50.0	66.0	5.0	13.0	11.0	189.0	239.0	293.0	25.0	34.0	48.0	12.2	19.7	18.9
..AZIL	14.2	18.0	18.3	61.2	66.9	73.2	5.7	6.3	5.8	262.1	258.0	324.0	24.4	24.4	25.8	19.5	19.4	20.4
..GENTINA	5.5	6.8	9.2	49.1	58.1	82.1	3.6	5.4	11.1	242.9	305.1	333.0	17.7	28.1	44.8	8.1	7.4	7.2
..NEZUELA	3.5	4.5	5.1	16.0	18.0	27.0	6.0	7.0	7.0	112.0	106.0	147.0	42.0	38.0	38.0	- 1.5	- 1.4	- 4.0
..ILE	2.1	2.5	3.0	34.0	41.0	50.0	8.0	8.0	12.0	170.0	238.0	292.0	39.0	44.0	68.0	3.2	5.9	4.0

* Gross interest and medium/long-term amortisation. In normal circumstances it is assumed that countries' short-term debt is rolled over as a matter of course and therefore maturities of such debt are excluded from the calculation of debt servicing commitments.

≠ Debt service as a % of exports of goods and services.

CONFIDENTIAL

ATTACHMENT 2

THE INTERNATIONAL BANKING SYSTEM

A: THE WORLD SYSTEM

Agreegate international lending

International business - that is overseas lending - represents a still small (but growing) proportion of the world banking system's total assets.

Table 1: Share of international lending in total bank assets (%)

1974	1976	1978	1980	1981
9.8	12.0	12.6	15.6	17.4

Loans to the two countries that are the largest developing country borrowers - Mexico and Brazil - amount in each case to about 1% of total bank assets.

2. So banks' international exposure is still small in relation to their domestic exposure, despite the rapid acceleration in the 1970s. A complete assessment of the world banking system's exposure should also include banks' domestic exposure - for example to particular problem sectors or companies. But no aggregate figures of this kind are available.

3. International lending mushroomed in 1973/4 (temporarily growing at over 50% per year) as oil surpluses were recycled. Since 1974 the growth of lending has been fast, but fairly steady, at around 20-25% a year; the pace accelerated slightly in 1978/9 as countries first rebuilt their liquidity in the easier market conditions of 1978 and then were forced into further borrowing by the oil price rise of 1979, but has been gradually slackening subsequently to slightly under 20%.

Table 2: International claims of banks in the BIS area (excluding claims on other BIS area banks).

$ billion, end year

1973	1974	1975	1976	1977	1978	1979	1980	1981
175	245	285	355	430	535	665	810	940

Of course, part of this growth is a reflection of inflation - the US price level doubled in this period.

4. The rate of growth has slowed recently. New lending in the first quarter of 1982 is estimated at $20 billion; compared with $30 billion in Q1 1981. It has probably slowed further since March but, complete figures are not yet available.

Geographical Exposure

Table 3: Distribution of international claims of BIS banks (excluding claims on other BIS area banks) end 1981 ($bn)

BIS countries and off-shore centres	Other industrial countries	Eastern Europe	Oil Exporters	Other developing countries: Latin America	Other developing countries: Others
478	99	61	72	159	71

Table 4: Of which: credit to the top ten developing country borrowers from banks:

Debt to BIS banks, December 1981, $ billions

Mexico	55	(88)*
Brazil	50	(81)*
Venezuela	22	(28)*
Argentina	23	(37)*
Korea	17	(33)*
Yugoslavia	10	(18)*
Philippines	7	(17)*
Chile	10	(17)*
Greece	9	n.a
Algeria	7	(16)*

*Estimated total external debt in 1982 (including debts to Governments, non-banks everywhere and banks outside the BIS area).

5. At end 1981 these top ten borrowers, within which Latin American countries predominate, accounted for around 58% of all borrowing by developing countries(ie Ldc's + OPEC and Eastern Europe).

Table 5: Other major borrowers from BIS banks (Dec 1981 $ billion)

Spain	27	na
GDR	10	(15)*
Poland	15	(30)*
USSR	16	(20)*

*see note on Table 4

It might also be helpful to look at the debt of the developing countries as a whole.

Table 6: Developing countries (a) gross long term external debt

$ bns

	1973	1978	1981
Total	97.3	272.7	425.2
(as % of GNP)	(15.3)	(19.5)	(22.0)
By type of creditor:			
official	49.1	117.8	180.0
private	48.3	154.9	245.3
By type of borrower:			
net oil exporters	15.6	61.5	86.6
net oil importers:			
major exporters of manufactures	38.9	107.9	162.7
low income countries	21.6	46.2	69.3
other net oil importers	21.2	57.1	106.6

Source: World Bank

(a) includes Greece, Portugal, Turkey, Yugoslavia, Oman and the OPEC high absorbers.

Adjustment for inflation is difficult to interpret because relevant inflation rates vary so much from borrower to borrower. However, the following table gives some impression.

Table 7: Nominal and real external debt of the developing countries

$ bns

	1973	1974	1975	1976	1977	1978	1979	1980	1981	% of 1973
Nominal	97.3	120.6	147.1	176.5	216.7	272.7	322.8	370.1	425.2	(437)
at end 1981 trade prices	238.4	217.8	265.6	297.0	336.6	378.5	348.5	360.0	425.2	(178)

[Source of debt data: IMF Task Force on Non-Concessional Flows]
The 1981 level is expressed as a percentage of 1973 as a guide.

Capital Adequacy

6. Banking capital ratios have remained steady or in some cases declined a little in recent years, but the figures show no sharp deterioration. Because of rising credit risks banks may be slowing the pace of new lending and supervisors in the G10 countries have concluded that further erosion in banks' capital ratios should be resisted.

B: BRITISH BANKS' OVERSEAS EXPOSURE

7. The aggregate statistics for international exposure are, of course, much lower than those for the major banks traditionally most involved in international lending. For the latter, a proportion of about 50% would not be unusual. Much of this will be to other industrialised countries, but in many cases their exposure to the developing countries as a group would exceed their own capital.

The position of London as the world's major international banking centre is reflected by the fact that British owned banks*too are proportionately much more exposed overseas than is the world banking system as a whole. Foreign lending out of London accounts for around 25% of total assets.

Some of the major US banks have more than half their business in international lending (Citicorp 62%; Chase and Morgan Guaranty 58%; Manufacturers Hanover 51%; Bank of America 42%). The proportion of French bank claims on foreign countries is 33%. Statistics for most other countries are generally not consolidated and therefore similar comparisons are not possible.

*ie, excluding the UK subsidiaries of foreign owned banks, and consortium banks.

in the wake of the Herstatt affair that they were satisfied that means were available for the provision of temporary liquidity to the euromarkets and would be used if and when necessary.

That statement still stands. As was also said in 1974, however, it would not be practicable or advisable to lay down in advance detailed rules and procedures for the provision of such liquidity. In particular, if such provision were to be in any sense automatic or if the factors or criteria which determined it were precisely specified, there would be a danger that the disciplines of the market would be overriden - if the arrangements looked too restrictive - or undermined, if they looked too lax."

Cooperation between supervisory authorities: the Concordat

11. Perhaps the most important single element of cooperation between supervisory authorities is what has come to be known as the "Concordat" on division of supervisory responsibility between national authorities for different banks and their branches and overseas subsidiaries. The basic principle is that no foreign banking establishment should escape supervision. A distinction is made between branches, which are an integral part of the bank, and locally incorporated subsidiaries and the division of responsibility is described below. The Concordat is supplemented by the principle of consolidated supervision so that a bank's capital adequacy and risk exposure can be assessed on the basis of the totality of its world-wide business, including its foreign branches, subsidiaries and affiliates.

12. The Concordat was described in more detail by the Bank of England in 1981 as follows :

"It sets out guidelines covering the responsibilities of different supervisory authorities for the ongoing supervision of banks where those banks operate in more than one national jurisdiction. It is not, and was never intended to be, an agreement about responsibilities for the provision of lender of last resort facilities to the international banking system, and there should not necessarily be considered to be any automatic link between acceptance of responsibility for ongoing supervision and the assumption of a lender of last resort role. The aim of the Concordat is to sustain as far as possible by effective supervision the health and safety of the existing structure. It does not set out to rule on the way in which the pieces of that structure should be picked up if it is broken. The Concordat encompasses the following principal guidelines and recommendations :

- The supervision of foreign banking establishments should be the joint responsibility of host and parent authorities.

- No foreign banking establishment should escape supervision, each country should ensure that foreign banking establishments are supervised, and supervision should be adequate as judged by both host and parent authorities.

- The supervision of liquidity should be the primary responsibility of host authorities since foreign establishments generally have to conform to local practices for their liquidity management and must comply with local regulations.

- The supervision of solvency of foreign branches should be essentially a matter for the parent authority. In the case of subsidiaries, while primary responsibility lies with the host authority, parent authorities should take account of the exposure of their domestic banks' foreign subsidiaries and joint ventures because of the parent banks' moral commitment in this regard.

- Practical cooperation would be facilitated by transfers of information between host and parent authorities and by the granting of permission for inspections by or on behalf of parent authorities on the territory of the host authority. Every effort should be made to remove any legal restraints (particularly in the field of professional secrecy or national sovereignty) which might hinder these forms of cooperation."

H M TREASURY

ANNEX

BANK FOR INTERNATIONAL SETTLEMENTS

15th April 1980

PRESS COMMUNIQUE

1. At their meetings in Basle on 10th March and 14th April the central-bank Governors of the Group of Ten countries and Switzerland exchanged views on the evolution during recent years, and the future prospects, of the international banking system in general, and the Euro-currency market in particular.

2. The Governors recognise the important part played by the banks in recycling large surpluses which have arisen during the last few years. They noted that international bank lending aggregates have been expanding at an annual rate of some 25 per cent. Moreover, the contribution of the international banking system to recycling the large OPEC surpluses that have re-emerged will lead to further substantial growth of these aggregates.

3. In view of the present volume of international bank lending and of its prospective future rôle the Governors are agreed on the importance of maintaining the soundness and stability of the international banking system and of seeking to avoid any undesirable effects either worldwide or on the conduct of policy in particular countries.

4. With these considerations in mind, the Governors have decided to strengthen regular and systematic monitoring of international banking developments, with a view to assessing their significance for the world economy, for the economies of individual countries, including particularly the operation of their domestic monetary policies, and for the soundness of the international banking system as a whole. A Standing Committee on Euro-markets will consider the international banking statistics compiled by the BIS and other relevant information and report to the Governors at least twice a year, and more frequently if developments call for it. These arrangements for closer surveillance could provide a framework for intensifying, if appropriate, co-operation on monetary policies between the countries concerned.

5. Recognising that individual banks, or the international banking system as a whole, could in future be exposed to greater risks than in the past, the Governors re-affirm the cardinal importance which they attach to the maintenance of sound banking standards - particularly with regard to capital adequacy, liquidity and concentration of risks. To this end they place high priority on bringing into full effect the initiatives already taken by the Committee on Banking Regulations and Supervisory Practices with regard to the supervision of banks' international business on a consolidated basis, improved assessment of country risk exposure, and the development of more comprehensive and consistent data for monitoring the extent of banks' maturity transformation.

6. The Governors note that differences in competitive conditions between domestic and international banking that arise out of official regulations and policies stimulate growth of international bank lending in general; and that transactions channelled through the Euro-currency market can pose problems for the effectiveness of domestic monetary policy in those countries where such differences are particularly significant. The Governors will continue efforts already being made to reduce the differences of competitive conditions, fully recognising the difficulties arising from differences in the national structure and traditions of banking systems.

Attachment 3.

DEBT STATISTICS

OFFICIAL CREDIT INSURERS' COMMITMENTS AT MARCH 1982 (including short term)

	Total Commitments* at 31 March 1982 $m	of which ECGD's $m	(as a percentage share)
1. EASTERN EUROPE			
Yugoslavia	5,147.8	1,273.5	24.7%
Bulgaria	760.4	22.7	3.0%
Czechoslovakia	1,477.2	104.9	7.1%
GDR	4,218.7	185.4	4.4%
Hungary	692.2	80.1	11.6%
Poland	9,731.2	1,856.1	19.1%
Romania	3,317.9	738.9	22.3%
USSR	17,350.3	1,423.1	8.2%
2. LATIN AMERICA			
Mexico	8,343.6	1,054.9	12.6%
Brazil	14,504.9	1,668.7	11.5%
Argentina	8,267.9	521.4	6.3%

*excluding COFACE (French Credit Insurance Agency); but including undisbursed commitments