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Late Item

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Mexican Bank Nationalization

Lopez Portillo's failure once again to address the need for austerity measures in his last State of the Union address raises to a new level domestic and international concerns about his willingness to take actions necessary to resolve the financial crisis. Instead, Lopez Portillo announced nationalization of Mexican banks and expanded exchange controls. The nationalization measure will affect some 50 private banks with assets of about $26 billion. Banks will be closed until 6 September while new policies are sorted out.

Lopez Portillo blamed Mexico's economic problems on international economic trends and on domestic bankers and speculators who he said sent $22 billion out of Mexico in the last two years. He characterized the finacial crisis as temporary. Contrary to widespread expectations among Mexican and international observers that he would announce new austerity measures, Lopez Portillo only stated that "enormous economic and political sacrifices" would be required to overcome Mexico's problems. He also made vague references about international financiers attempting to impose their economic prescriptions on Mexico.

Organized labor has been calling for full exchange controls and increasing intervention in banking and social sectors; the measures announced by Lopez Portillo may have been designed to ensure labor's continued support. By nationalizing the banks, Mexico City is guaranteeing continued solvency of banks that have been hard hit by the growing inability of many private-sector firms to repay loans. Nevertheless, private-sector confidence in the government will probably diminish and the nationalization is unlikely to curtail capital flight.

The imposition of more controls on the economy will complicate ongoing negotiations with the IMF and reduce chances of reaching an agreement by the mid-October target date. Meanwhile, international bankers will be unwilling to lend new money. The administration's failure to put into effect a viable austerity program soon would put even more strain on ruling party cohesion during the transition period.

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International Economic & Energy Weekly [redacted]

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Synopsis of This Issue

Perspective—*Economic Recovery in the OECD* [redacted] 25X1

The long-awaited economic recovery in the industrial countries is developing, but only weakly. Interest rates remain high, budget deficits are increasing, profit margins remain low, and unemployment continues to rise. This poor economic performance presages an environment in which alliance cooperation will be difficult to muster. [redacted] 25X1

25X1 [redacted]

The Changing Structure of Western Bank Lending [redacted] 25X1

Over the last several years non-US commercial banks have greatly stepped up their international lending to both corporate and government borrowers. In addition, the maturity structure of loans has been shortened and the cost of borrowing has risen, making it more difficult for borrowers to meet their financial obligations. [redacted] 25X1

Caribbean Countries: Dimensions of the External Financing Problem [redacted] 25X1

Real economic growth in the Caribbean region fell to 2.5 percent last year. We believe that the economic downturn is likely to bottom out in 1983. [redacted] 25X1

China: The Economy at Midyear [redacted] 25X1

Six months into 1982, Beijing is still struggling to restrain industrial growth, particularly in heavy industry. Efforts to get managers to focus on energy conservation and improvements in quality and productivity have met with little success. [redacted] 25X1

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International Economic & Energy Weekly

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3 September 1982

Perspective

Economic Recovery in the OECD

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The long-awaited economic recovery in the industrial countries is developing, but only weakly. Interest rates remain high, budget deficits are increasing, and profit margins remain low. Under these circumstances, it is hard to imagine much of a rebound in either spending or investment in the major industrial countries. This poor economic performance presages an environment in which alliance cooperation will be difficult to muster. 25X1

Economic growth in the four major West European countries should average about 2 percent in second-half 1982, up from 1.5 percent in the first six months of the year and 0.6 percent in second-half 1981. The West European unemployment problem in these circumstances will probably get worse. By yearend 1982, total OECD unemployment could reach 29 million—about 15 percent above the 1981 level. In several countries, unemployment rates will remain well above 10 percent; British unemployment stood at 12.5 percent in August, and about 16 percent of the Spanish labor force is idle. 25X1

The meager recovery that seems to be materializing could easily falter. For one thing, especially in Western Europe, recovery depends on an upturn in export sales. Given economic conditions in other industrial countries and the weakening position of major LDCs, this rebound may not occur. Japan, as in the past, is also counting on export expansion for a large share of its economic growth during the next 18 months. Among the major foreign countries, the Japanese and West Germans are probably in the best competitive position to increase foreign sales.

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One thing industrialized countries now have going for them is that inflation rates are tapering off. For the OECD as a whole, consumer prices in 1982 are expected to rise by 8.2 percent, the smallest annual increase since 1978. The improvement will not be uniform, and in some countries—such as France, Italy, and Spain—large budget deficits, rapid monetary growth, and probable currency depreciation against the dollar will contribute to continued double-digit inflation rates. The OECD's current account deficit also has begun to improve because of lower raw material prices, some export gains, and declining import volume.

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Altogether these conditions do not bode well for smooth international economic relations.

- Trade frictions will continue as countries attempt to bolster their own growth by protecting weak industries and boosting exports.
- Weak OECD growth will mean continued soft commodity markets that will hurt LDC capacity to handle debt and their role as markets for exports from developed countries.
- Although they are coming down US interest rates still will be blamed for the economic malaise in the West. [redacted] 25X1

[redacted] 25X1

Briefs

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Energy

Iran Moves To Offset Iraqi Air Attacks

[redacted]

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[redacted] National Iranian Oil Company is now offering crude oil at a discount price of $28 per barrel. The new discount, $3.20 below official prices, is intended to offset the tripling in insurance premiums and the doubling in charter rates—now totaling $2.36 per barrel—resulting from the recent Iraqi air attacks on Khark. [redacted] 25X1

Although exports may have fallen to around 1.5 million b/d immediately following the recent Iraqi air attacks at Khark, we believe Iran will continue substantially discounting to return exports to previous levels of about 2.0 million b/d. Buyers are reportedly still actively seeking tankers and owners are accepting new charters to load at Khark. Only if Iraq inflicts major damage to foreign tankers or oil export facilities, will Iranian exports be seriously impeded for any length of time. [redacted] 25X1

UK Oil and Gas Trends

The United Kingdom was the only major industrial country to experience a rise in oil consumption during first-half 1982. Despite continued sluggish economic growth, oil use increased 3 percent over year-earlier levels, reflecting in part the improvement in oil prices relative to the major competing fuel, natural gas. The explosive growth in natural gas demand experienced during the last two decades seems to have finally stopped, as gas usage recorded its first decline in 30 years, down 1 percent through midyear. With prospects for continued stagnation in the UK economy and gradually increasing gas prices as a result of UK policy decisions, gas consumption for the balance of the 1980s could fall well below previous expectations. This could reduce the need for additional Norwegian imports, thus freeing up supplies for the Continent. [redacted]

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Indonesia Holds Oil Prices Firm

President Soeharto reportedly rejected last week a plan to trim Indonesian oil prices in an apparent move to maintain OPEC unity. Unless Japan steps up purchases of Indonesian crude as a result of recent attacks on Iran's Khark Island export facility, however, Jakarta will continue to experience difficulty marketing its relatively high-priced crude. Japan, which presently buys nearly

60 percent of Indonesia's crude, probably will continue to demand that Jakarta find some way to boost the competitiveness of its oil. Indonesia's oil revenues, the mainstay of the country's economy, have already dropped 25 percent this year as a result of its production and pricing policies. [redacted] 25X1

International Trade, Technology, and Finance

West European Lower Interest Rates

The rapid decline in US interest rates has triggered a round of rate cuts in Western Europe. In the last two weeks, six West European central banks—the Belgian, Italian, Dutch, Swiss, Austrian, and West German—have cut discount rates by as much as 1 percentage point. The Bundesbank trimmed its discount rate to 7 percent from the 7.5 percent that had been in place since May 1980; the Lombard rate—the rate for loans secured by bonds and equities—was lowered by 1 percentage point to 8 percent. The financial press reports that the Bank of England also is moving to ease interest rates. If US interest rates continue to fall, however, West European rates are unlikely to keep pace. The Bank of France has not cut its rates reportedly because it fears downward pressure on the franc. Other central bankers in Western Europe may well hold back on reductions in their interest rates in an attempt to strengthen their currencies against the US dollar. Moreover, real interest rates in most West European countries have been only one-third to one-half the level of real rates in the United States. [redacted] 25X1

IMF Meeting

Next week's IMF meeting in Toronto will discuss increasing member country contributions to the Fund under the Eighth General Review of quotas. Most of the major foreign industrial nations support an increase in the IMF's current $65.9 billion capital base by anywhere from 50 to 100 percent. No agreement on the size of the quota increase is likely at this year's meeting, but in our judgment, most industrial nations probably will not accept an increase below $30 billion. The meeting comes at a time when a growing number of LDCs are being forced to turn to the IMF because of the difficulties in servicing their debt obligations. Mexico—the largest LDC debtor—has recently announced its intention to go to the IMF for loans of $4-5 billion, while Argentina—the third-largest debtor—has indicated it will draw amounts up to $1.5 billion. [redacted] 25X1

LDC Textile Exporters Meet

The 12 less developed country textile and apparel exporters who have so far rejected EC demands for new export restrictions under the Multifiber Arrangement are meeting this week in Geneva to discuss their strategy for the second round of bilateral negotiations scheduled for this month. Earlier this year the three major textile and apparel exporters to the EC—South Korea, Hong

Kong, and Macao—refused to go along with EC demands that included a yearly reduction in export quotas of 10 to 12 percent for three years. They have been supported by nine other exporters, but 14 others, including Thailand and Pakistan, agreed to the EC terms. Although a hard stand by the developing country exporters might produce minor EC concessions, the exporters have little leverage and probably will yield before the late September negotiating deadline imposed by the EC rather than face the prospect of selective restrictions. EC success in splitting the LDC exporter ranks makes it unlikely the EC will withdraw from the MFA, a move which would have ended the nine-year-old arrangement.

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National Developments

Developed Countries

EC Commission Penalizes Steel Producers

The EC Commission's recent imposition of $15 million in fines against European steel companies that have exceeded their production quotas indicates the Commission is actively enforcing the production limitation system included in the Community's overall steel restructuring program. The eight steel firms involved together produced almost 200,000 tons of steel beyond their quotas between the fourth quarter of 1980 and the third quarter of 1981. The fines, however, may not be paid. Kloeckner, a West German firm that was assessed the largest fine—about $9.8 million—intends to appeal the Commission's decision to the European Court of Justice and if necessary will open proceedings in West German courts. If Kloeckner succeeds in avoiding payment of its fine, the quota system, along with the Commission's overall program for restructuring the industry, could be jeopardized.

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Less Developed Countries

Egyptian Economic Ministers Shifted

President Mubarak's concern about growing domestic criticism of his failure to deal effectively with Egypt's serious economic problems is reflected in Wednesday's cabinet changes. Mubarak dropped Deputy Prime Minister for Economic Affairs Ibrahim and abolished the position. The new Minister of International Investment and Cooperation is Dr. Wagih Shindy, chairman of the ruling National Democratic Party's Budget and Planning Committee and head of the government-owned Arab Investment Bank. According to Embassy reporting, Shindy is well liked by the private sector and has demonstrated a solid understanding of the need for economic policy changes as well as the political risks involved. In his new position, he will oversee foreign investment outside the oil sector and be the point man for US aid relations. The new Minister for Economy and Foreign Trade, Dr. Mustafa Said, also has worked on key party economic committees and, along with Shindy, authored a long critique of Egyptian economic problems and policies in 1980. Their recommendations for improving the performance of public-sector industries and limiting conspicuous luxury consumption were largely ignored by Sadat, but probably will form the basis for future policies.

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The shift in economic ministers is intended to convince Egyptians that Mubarak plans to deal more actively with Egyptian economic problems in the months ahead. Mubarak has been pursuing a cautious approach toward the economy in order to maintain stability after Sadat's assassination and to ameliorate the erratic policies of former Deputy Prime Minister Meguid. Mubarak's caution, however, has been interpreted as indecisiveness by a wide range of Egyptian interest groups. We believe Mubarak probably has greater trust in his new economic ministers and plans to give them more leeway in formulating policy changes. Nevertheless, the new economic team is unlikely to propose sweeping economic reforms that carry significant political risks.

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Argentina's New Economic Team

The 24 August resignation of Argentine Economy Minister Dagnino—after only seven weeks in office—has brought to power an economic policy team likely to offer little effective resistance to President Bignone's growing use of populist remedies to assuage public discontent. Buenos Aires announced on 26 August another 30-percent wage hike to stem labor unrest, although the new salary adjustment will only drive inflation higher. Jorge Wehbe, the new Economy Minister, has promised seemingly inconsistent policies aimed at halting the inflationary spiral and improving government revenues, while developing an emergency housing construction and public works program. In contrast, Julio Gonazalez del Solar, the new Central Bank president, is a free market proponent; the US Embassy reports he favors moves to reduce public expenditures, tighten controls over monetary expansion, and promote Argentine exports. The lack of coordinated economic leadership has worrisome implications. Divergent priorities will probably undermine any effort to formulate and implement a coherent stabilization program; this would both heighten foreign lenders' concerns and foster resistance to new financing. In the worst case, excessive policy zigzags could lay the foundation for economic crisis by paralyzing industrial activity, disrupting export marketing, and causing foreign bankers to refuse further debt rollovers.

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Prospects For Reconstruction in Lebanon

The PLO exodus from Beirut and the election of Bashir Jumayyil as President are unlikely to enable Lebanon to soon regain its status as the financial, transportation, and communications center for the Middle East. Political instability and the Israeli presence will limit, at least in the short run, the amount of funds multinational lending agencies and the wealthy Arab states are willing to commit. A modest reconstruction effort to repair and replace buildings and infrastructure in the heaviest hit areas is more feasible and could get under way without much delay. [redacted] 25X1

Lebanese economic planners say at least $12 billion in grants and concessional loans from abroad will be needed for reconstruction, according to a press report. These funds would be used to repair damage inflicted during the Israeli invasion, as well as damage that occurred during the 1975-76 civil war. The Chairman of the Council for Reconstruction and Development said the government will oversee the restoration of such things as roads, schools, hospitals, and water and power supplies and leave housing to private companies subsidized by the government. Municipal authorities, according to a press report, estimate that one-fourth of the buildings in West Beirut are heavily damaged or destroyed. [redacted]

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With foreign exchange reserves of $1.3 billion and an estimated $2 billion in annual worker remittances, the Lebanese can cover some of the foreign exchange costs of reconstruction themselves. Reduced output because of damage inflicted during the Israeli invasion and lack of government control in many areas of the country will, however, hinder efforts to collect taxes. Lebanese political and business leaders have recently expressed the hope to US Embassy officials that the United States will launch a "mini-Marshall Plan." Saudi Arabia, other Arab oil-producing states, and the World Bank have also been mentioned as possible donors. The World Bank has expressed a willingness to take the lead on reconstruction efforts if a strong central government is established and the government can exercise control throughout the country. This will take some time. [redacted] 25X1

With the election of Jumayyil, who has close ties to Israel, the Arabs may be reluctant to provide reconstruction aid. Lebanon's Sunnis are extremely distrustful of Jumayyil, and Arab leaders, whose populations are predominantly Sunni, may find it difficult to grant large sums to a government dominated by Jumayyil. If Jumayyil takes steps toward a reconciliation with the Sunnis, the Arabs would probably be willing to provide some assistance. The Israeli presence in southern Lebanon, where economic ties to Israel are already being developed, is an additional complication. Potential donors would be reluctant to provide aid that could be perceived as beneficial to Israel. [redacted] 25X1

Even if Lebanon's massive political problems are resolved, there is little economic incentive for the Arabs to pump money into Lebanon. Prior to the civil war, Beirut was the hub of Arab trade, banking, transportation, and communications. Since the civil war, however, most Arab countries have developed their own service industries and Beirut may not be able to recapture its preeminent position in the Arab world. Bahrain has become a major financial center, and Saudi banking is developing rapidly. Saudi Arabia and Jordan have greatly expanded their own airlines, and most Arab states have installed their own communications facilities. Wealthy Arabs have found other locations—Monte Carlo and London, for example—to enjoy the night life. The younger generation is now being educated in England or the United States. Most of the services Beirut once provided are now being supplied elsewhere. [redacted]

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Zimbabwe May Seek PL-480 Assistance

Faced with shortages of bread and edible oils, Zimbabwe has asked US Embassy officials about the availability of PL-480 Title I assistance. Title I aid would provide for concessional financing for the 70,000 tons of wheat and 8,000 tons of edible oil necessary to cover anticipated 1982-83 needs. Consumer demand has been fueled by sharp increases over the past year in government-mandated minimum wages, while domestic food supplies have been reduced by drought. Harare claims, however, that only short-term assistance will be needed as it expects that its policy of higher producer prices and lower consumer subsidies will restore domestic self-sufficiency within two years [redacted]

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Tanzania Scrambles for Assistance

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Dar es Salaam's latest search for aid is yielding negligible results. Consequently, Tanzania cannot pay for recent oil shipments from Abu Dhabi and Qatar, and government officials fear that the country will run out of oil by October. [redacted] This comes on top of Tanzania's disappointing talks with the IMF last month. Although Nyerere grudgingly devalued the shilling 10 percent and raised domestic interest rates earlier this year to placate the IMF, the Fund is insisting on a further 50 to 60 percent devaluation and the reduction of the burgeoning budget deficit. [redacted]

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Communist

[redacted]

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[redacted]

Financial Picture Brightens for Soviet Grain Buyers

The financial picture has brightened considerably for Soviet grain buyers since purchases of 6 million tons of Canadian and Argentine grain were reportedly made in early June. During the past two months US grain prices have steadily declined, reaching three-year lows, and the London Interbank Offered Rate—used to determine the interest rate charged the Soviets for short-term grain credits—has dropped by one-third. The result is a potential saving to Moscow of roughly $20 million on every 1 million tons of grain purchased. In addition, the price of gold, which Moscow has sold in the past to help finance grain imports, has risen 27 percent to over $400 per ounce since June. Most observers believe that the Soviets will gain little by a further delay in grain purchases, but because sharp turnarounds in prices and interest rates are not anticipated, Moscow can sit on the sidelines a while longer before making the major purchases and still realize a savings. Large grain stocks, particularly in the United States, and the near certainty of another bumper global grain harvest assure the Soviets that ample grain supplies will be available from exporters until at least late next spring. [redacted] 25X1

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Worsening Yugoslav Financial Problems

Newly released data from the Yugoslav National Bank show earnings from exports and services are running more than $3.5 billion below Yugoslavia's initial projection for 1982. This shortfall and severe reductions in Western credits are forcing the Yugoslavs to slash imports, resulting in a decline in industrial output. The data also indicate that even with import reductions, the Yugoslavs are more than $1 billion short of covering their obligations for this year. The National Bank's bleak projections provide more evidence that Yugoslavia may be unable to meet scheduled payments in the months ahead. Belgrade's official reserves already are low, and its new foreign exchange law has not yet enabled the National Bank to tap the holdings of regional banks. Western bankers are taking a more pessimistic view of Yugoslavia's creditworthiness, and negotiations for a syndicated loan are stalled. The Yugoslavs will find it difficult to cut imports further, because industry is already suffering from shortages of energy and raw materials. 25X1

Cuban Debt Rescheduling

Havana has decided to seek rescheduling arrangements on its approximately $3 billion hard currency debt. The Cuban National Bank is proposing the rescheduling of principal payments on its medium- and long-term debt over a 10-year period. Cuba would continue to pay interest and administrative costs associated with these loans, as well as both interest and principal on short-term obligations. Because of the large number of institutions involved, an advisory committee probably will be formed to handle rescheduling arrangements. Creditors from Japan, France, Canada, and Spain—Cuba's most important Western trading partners—would be likely to take an influential role in the discussions. 25X1

Payments pressures have intensified markedly over the past year. Import cuts have not relieved financial pressures brought on by the steep drop in the world price of sugar, Cuba's major export. Cuban banking officials have tried to secure Western loans, but in recent months bankers have become more wary of lending to Cuba. Moreover, financial pressures will grow over the next few years because Cuba's export prospects are poor and a large portion of Havana's hard currency debt is coming due. 25X1

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The Changing Structure of Western Bank Lending [redacted]

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Over the last several years, non-US commercial banks have greatly stepped up their international lending to both corporate and government borrowers. Although US banks' share of new loans increased slightly last year to 29 percent, it was still well below the 38-percent share reached in 1976. In a more recent development, banks in general are substantially shortening the maturity structure of new loans, reflecting their concern about debt reschedulings and borrowers' ability to maintain payments on longer term instruments. The shorter terms along with higher interest rates and fees are making it more difficult for weaker borrowers to meet their financial obligations. At the same time, the greater internationalization of bank lending along with increasing complexity of banking relationships is complicating the issue of who will be the lender of last resort in the event of a liquidity crunch. [redacted]

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Non-US Banks' Share Grows

Since the mid-1970s banks in foreign industrial countries have increased their international lending at an average annual rate of 25 percent compared with average annual US loan growth of 18 percent. As a result, US banks' share of outstanding international loans dropped from 38 percent in December 1976 to 27 percent in 1980. The US share moved back up to 29 percent last year primarily because of sizable increases in US bank lending to developed country borrowers and because of appreciation of the dollar. [redacted]

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The rapid growth in non-US banks' lending stems from the same factors that first attracted US banks. Particularly important has been the desire of LDCs and the centrally planned economies to obtain external financing for economic development. Other factors are:

- The greater profitability of international compared with domestic lending, which stems in part from the absence of legal restraints on reserve requirements, rates, or fees.
- The banks' need for asset diversification.
- Multinational corporations' demand for large-scale, multicurrency funding.
- The opportunity to intermediate between surplus and deficit countries.
- Political constraints on direct investments.

The accelerated foreign lending by West European, Japanese, and Canadian banks has occurred across the entire geographic spectrum. Most dramatic has been the sixfold increase in non-US bank lending to OPEC since the mid-1970s, which resulted from an aggressive marketing effort. [redacted]

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Foreign banks have substantially increased their share of what have traditionally been the largest LDC lending markets for US banks. About three-fourths of total US bank loans to non-OPEC LDCs are concentrated in six countries—Brazil, Mexico, South Korea, Argentina, Taiwan, and the Philippines. The US share of these countries' bank debt has dropped significantly in recent years, ranging from a decline of 15 percentage points in Brazil and the Philippines to about 25 percentage points in Mexico and South Korea. Only in Taiwan has the US share increased. The rise in non-US bank lending to these countries can be attributed primarily to the previously low exposure of non-US banks in these LDCs. Moreover, according to a Comptroller of the Currency study, in the late 1970s many US banks were nearing government-prescribed lending limits in these countries and could not increase loans rapidly enough to meet the demand.[1] [redacted]

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[1] Lending limits are imposed on banks by government regulators as a constraint on the amount a bank may lend to a single borrower. These limits are stated as a ratio of bank capital (for example, equity) to bank assets (for example, loans). [redacted]

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Outstanding International Claims of Commercial Banks Reporting to the Bank for International Settlements

Billion US $

	Dec 1975	Dec 1976	Dec 1977	Dec 1978	Dec 1979	Dec 1980	Dec 1981
World total [a]	**411**	**514**	**650**	**839**	**1,029**	**1,233**	**1,416**
Non-US banks	263	319	424	584	744	903	1,006
US banks	148	195	226	255	285	330	410
US share *(percent)*	36	38	35	30	28	27	29
G-10 countries and Switzerland [a]	**204**	**236**	**291**	**387**	**472**	**578**	**650**
Non-US banks	150	171	217	302	380	470	519
US banks	55	65	73	84	92	108	131
US share *(percent)*	27	28	25	22	20	19	20
Offshore banking centers	**58**	**79**	**93**	**117**	**149**	**180**	**230**
Non-US banks	24	28	35	51	73	94	114
US banks	34	51	59	66	76	86	116
US share *(percent)*	59	65	63	57	51	48	50
Smaller developed countries [b]	**38**	**51**	**71**	**84**	**98**	**112**	**125**
Non-US banks	28	37	55	67	79	90	98
US banks	10	14	16	18	19	21	27
US share *(percent)*	27	27	22	21	20	19	22
OPEC countries [c]	**14**	**24**	**39**	**56**	**64**	**70**	**72**
Non-US banks	7	11	19	35	44	49	49
US banks	7	13	20	22	20	21	23
US share *(percent)*	52	53	51	39	32	31	32
Non-OPEC developing countries	**63**	**81**	**99**	**122**	**159**	**195**	**230**
Non-US banks	29	39	52	72	100	122	140
US banks	34	42	47	50	59	73	90
US share *(percent)*	54	52	48	41	37	37	39
East European countries [d]	**23**	**32**	**42**	**53**	**63**	**69**	**71**
Non-US banks	20	27	36	47	56	62	63
US banks	3	5	6	6	7	7	8
US share *(percent)*	14	15	14	11	11	11	11
Miscellaneous and unallocated [e]	**9**	**11**	**15**	**19**	**24**	**29**	**38**
Non-US banks	4	6	10	11	12	16	21
US banks	5	5	5	8	12	13	17
US share *(percent)*	54	50	35	43	49	45	45

[a] Excludes claims on the United States.
[b] Other West European countries plus Australia, South Africa, and Turkey.
[c] Includes Bahrain and Oman.
[d] Includes Yugoslavia.
[e] Includes Liberia and New Zealand.

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Outstanding International Claims of Commercial Banks Reporting to the Bank for International Settlements on Non-OPEC Developing Countries

	December 1976			December 1981		
	Total *(billion US $)*	US Banks *(billion US $)*	US Share *(percent)*	Total *(billion US $)*	US Banks *(billion US $)*	US Share *(percent)*
Non-OPEC Developing Countries	**80.9**	**41.9**	**52**	**230.0**	**90.0**	**39**
Mexico	17.9	11.7	66	55.4	21.6	39
Brazil	21.2	10.9	52	49.6	18.4	37
Argentina	3.4	1.9	57	22.9	9.5	41
South Korea	3.9	3.0	77	16.5	8.7	53
Chile	1.1	0.8	72	9.6	5.4	56
Philippines	2.6	2.0	76	7.2	4.4	61
Taiwan	2.6	2.0	77	5.6	4.5	80
Others	28.2	9.6	34	63.2	17.5	28

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US banks began to accelerate lending to both LDCs and developed countries in 1980 and 1981. The acceleration followed the 1979 oil price increase, which increased the demand for international lending, and the clarification by US bank regulators of a statutory provision on the amount that can be lent to a single foreign government (up to 10 percent of bank capital). According to the clarification, a government is no longer necessarily considered a single borrower. Each loan is now subject to a "purpose and means test" that effectively makes a government a multiple independent borrower. Much of the increased US lending has centered in the six big LDC borrowers, particularly Mexico where new US bank loans rose 30 to 35 percent in each of the past two years.

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Terms of Lending

The cost of borrowing from banks has substantially increased in the past few years as terms have stiffened. Although the increased competition among banks drove down spreads for LDCs to an average of 0.87 percentage point above LIBOR by 1979, they have risen steadily since then—to 1.03 in first-half 1982. The increase in spreads has come on top of much higher interest rates. LIBOR, the base rate for most Eurocurrency loans (the largest market for international bank transactions), rose from an average of 12 percent in 1979 to 16.8 percent in 1981. It has come down somewhat this year, averaging 15 percent for the first six months.

Finally, international bankers are increasingly unwilling to lend long term. According to the Bank for International Settlements, 54 percent of the total growth in bank lending to borrowers outside the BIS reporting area in second-half 1981 matures in one year or less. Of the new lending to Eastern Europe, 90 percent was in this bracket. Because of the shorter maturity of new lending, the share of

Share of Total Outstanding International Claims of BIS Reporting Banks Maturing in One Year or Less *Percent*

	1976 4th Qtr	1978 2nd Qtr	1979 2nd Qtr	1980 2nd Qtr	1981 2nd Qtr	1981 4th Qtr
Total	**47.2**	**45.3**	**44.0**	**43.3**	**46.3**	**47.0**
Developed countries outside the BIS reporting area [a]	46.9	42.7	40.1	39.1	41.1	41.4
Eastern Europe	50.2	45.5	43.1	37.2	39.4	42.0
Less developed countries (including OPEC)	46.5	46.3	45.3	46.2	49.3	49.7

[a] The reporting area consists of the Group of Ten countries (United States, Canada, United Kingdom, West Germany, France, Italy, Japan, Belgium, Luxembourg, and Netherlands) plus Switzerland, Austria, Denmark, and Ireland and certain of their bank affiliates. International claims among these countries are excluded.

[redacted]

Western banks' outstanding international claims maturing within one year has drifted back almost to what it was in 1976—47 percent. Because of the size of the Polish and Romanian debt reschedulings, however, the maturity structure of East European bank debt is now longer than for most LDC and many developed country borrowers.[2] [redacted]

We believe that the drift to shorter maturities in international lending is due to bankers' concern about the debt reschedulings and the risk that many government borrowers will not be able to earn enough foreign exchange to maintain the flow of payments on a debt instrument of longer maturity. [redacted]

Issues of Concern

The changes in the structure of international bank lending raise potential problems for borrowers. The issuance of more short-term debt increases uncertainty for borrowers, especially if they are forced to borrow short-term for long-term needs. As a result, many countries must constantly roll over a large portion of their external obligations, which increases the likelihood of a foreign exchange crisis. [redacted]

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From the creditors' point of view, the greater share of lending being undertaken by non-US banks has spread the risk among more countries and institutions. However, questions have been raised about who will act when borrowers and/or lenders get into serious trouble. The recent liquidation of Italy's Banco Ambrosiano is a case in point. The Bank of Italy refused to take over the debts of Banco Ambrosiano's operation in Luxembourg partly on the ground that it is a foreign subsidiary and therefore not the Bank of Italy's responsibility. If other Western central banks adopt the Bank of Italy's policy toward foreign subsidiaries, international banking would be truly vulnerable in a severe liquidity crisis. [redacted]

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[2] Typically, in a debt rescheduling the original loan contract is amended to include a grace period or a stretching out of the maturity structure. Some terms—usually the interest rate and often fees and commissions—are changed to compensate the lender. [redacted]

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Caribbean Countries: Dimensions of the External Financing Problem [1] [redacted]

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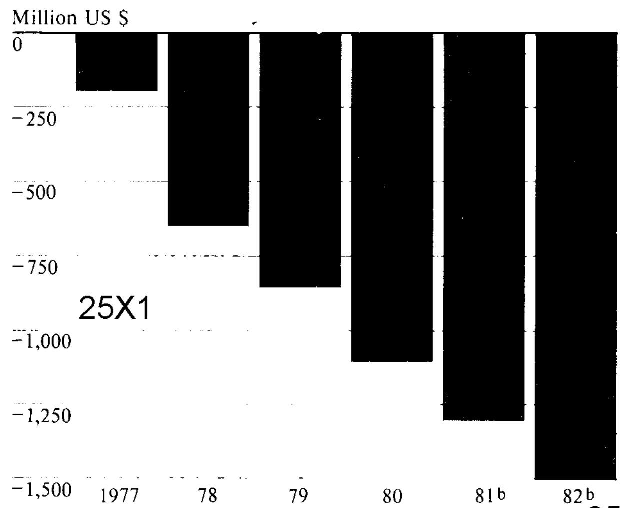
Real economic growth in the Caribbean region fell to 2.5 percent last year, compared to nearly 4 percent in 1977; the combined current account deficit ballooned from about $200 million in 1977 to an estimated $1.3 billion in 1981 (excluding the French Overseas Departments of French Guiana, Guadeloupe, and Martinique). Increased borrowing to help finance the worsening current account deficit has pushed the region's medium- and long-term external debt from $3 billion to $5 billion over the same period. [redacted]

We believe that the economic downturn is likely to bottom out in 1983. Current account deficits are expected to level off and in some cases improve due to a moderate upturn in the industrialized countries and a leveling off of oil prices. Given projected levels of foreign assistance, no major financing problems are foreseen for 1983. [redacted]

Current Account Balance for the Caribbean Region[a]



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[a] Goods, services, and private transfers.
[b] Estimated.

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[redacted]
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Factors Behind Widening Current Account Deficits

The serious setbacks suffered by Caribbean countries in their external accounts since 1977 have been due to a combination of factors. The OECD-wide recession has cut tourism earnings and has weakened the demand for traditional exports, particularly bauxite. In some countries, such as the Bahamas and Barbados, the tourist industry has also been hurt by high wage settlements. Unlike 1973-74, when commodity prices rose along with oil prices, commodity prices have been weak since 1980. World market prices for sugar, for example, have plummeted nearly 60 percent from 1980 levels, while bauxite prices have been flat. Moreover, for sugar producers that sell to the EC under guaranteed prices, a stengthening US dollar has reduced the dollar equivalent of the EC prices received. [redacted]

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[1] The Caribbean region is defined in this article to include Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Belize, the Cayman Islands, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Montserrat, the Netherlands Antilles, St. Christopher–Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, the British Virgin Islands, and the French Departments of French Guiana, Guadeloupe, and Martinique. [redacted]

Net Resource Flows and Official Development Assistance (ODA) to the Caribbean Region [a]

Million US $

	1975	1976	1977	1978	1979	1980
Total						
All sources	**1,505.8**	**1,686.9**	**1,841.0**	**2,765.0**	**2,589.3**	**2,423.2**
ODA	**634.7**	**786.7**	**801.6**	**983.6**	**1,146.1**	**1,449.5**
Anguilla						
All sources	1.7	1.1	1.1	2.3	2.3	2.3
ODA	1.7	1.1	1.1	2.3	2.3	2.3
Antigua and Barbuda						
All sources	2.6	3.4	5.5	5.6	3.3	6.5
ODA	2.1	3.1	5.4	3.6	3.3	5.6
Bahamas						
All sources	261.5	558.3	153.6	617.4	748.0	62.6
ODA	0.7	0.6	0.6	2.3	1.4	2.1
Barbados						
All sources	−11.3	27.6	11.0	14.9	45.7	19.1
ODA	5.4	7.6	5.8	11.3	11.1	13.9
Belize						
All sources	13.9	11.2	9.1	18.1	19.7	17.9
ODA	8.7	11.6	9.6	18.2	20.7	14.7
Cayman Islands						
All sources	28.6	14.2	146.7	152.9	350.1	279.2
ODA	1.6	2.1	1.5	3.2	0.7	1.5
Dominica						
All sources	8.0	4.6	5.0	6.5	8.8	17.4
ODA	7.9	4.3	5.0	7.1	9.1	17.7
Dominican Republic						
All sources	53.3	48.4	80.2	35.2	128.0	155.7
ODA	30.7	33.0	33.6	49.9	77.7	125.0
French Guiana						
All sources	53.8	68.3	88.6	86.5	92.3	111.7
ODA	45.4	63.5	85.3	78.9	92.5	111.7
Grenada						
All sources	2.7	2.7	3.3	2.7	2.9	3.7
ODA	2.8	2.7	3.3	2.6	2.9	3.2
Guadeloupe						
All sources	180.6	200.0	201.8	238.3	290.6	170.8
ODA	150.3	166.5	158.2	191.7	232.6	88.9
Guyana						
All sources	37.2	61.7	19.7	52.0	42.4	48.6
ODA	10.2	17.0	11.9	28.4	34.8	43.1

Net Resource Flows and Official Development Assistance (ODA) to the Caribbean Region [a] (continued)

Million US $

	1975	1976	1977	1978	1979	1980
Haiti						
All sources	56.5	70.1	88.0	94.5	128.7	120.7
ODA	59.3	71.8	87.6	92.8	92.6	105.2
Jamaica						
All sources	93.8	−12.1	67.0	116.4	90.4	216.4
ODA	25.1	26.2	33.3	122.1	97.5	126.0
Martinique						
All sources	200.6	227.6	238.8	287.4	334.6	738.6
ODA	164.7	194.6	202.1	235.4	296.1	568.8
Montserrat						
All sources	4.5	3.4	3.2	1.4	1.4	3.9
ODA	4.5	3.4	3.2	1.4	1.4	3.7
Netherlands Antilles						
All sources	421.3	274.7	605.0	851.2	110.7	204.8
ODA	33.3	49.3	41.6	48.0	56.9	96.6
St. Christopher–Nevis						
All sources	1.6	2.6	2.3	2.2	1.8	6.2
ODA	1.6	2.6	2.6	2.1	1.8	6.2
St. Lucia						
All sources	10.5	7.8	6.8	3.8	2.2	9.7
ODA	8.9	7.2	4.4	3.7	2.2	8.6
St. Vincent and the Grenadines						
All sources	6.1	4.4	4.0	4.6	5.7	10.7
ODA	6.0	4.0	4.0	4.5	5.7	9.7
Suriname						
All sources	56.8	104.9	106.5	66.8	94.6	80.1
ODA	52.8	103.8	90.2	65.6	94.6	82.2
Trinidad and Tobago						
All sources	16.1	−4.0	−11.3	104.8	74.2	67.8
ODA	5.4	4.3	5.7	4.5	4.1	4.7
Turks and Caicos Islands						
All sources	1.7	2.6	2.3	1.6	1.6	1.8
ODA	3.2	3.8	3.5	2.8	2.3	3.4
British Virgin Islands						
All sources	3.7	3.4	2.8	−2.1	9.3	67.0
ODA	2.4	2.6	2.1	1.2	1.8	4.7

[a] Net resource flows include ODA (grants and concessional loans) plus nonconcessional loans and direct investment. For individual countries ODA will exceed flows from all sources if non-ODA flows are negative.

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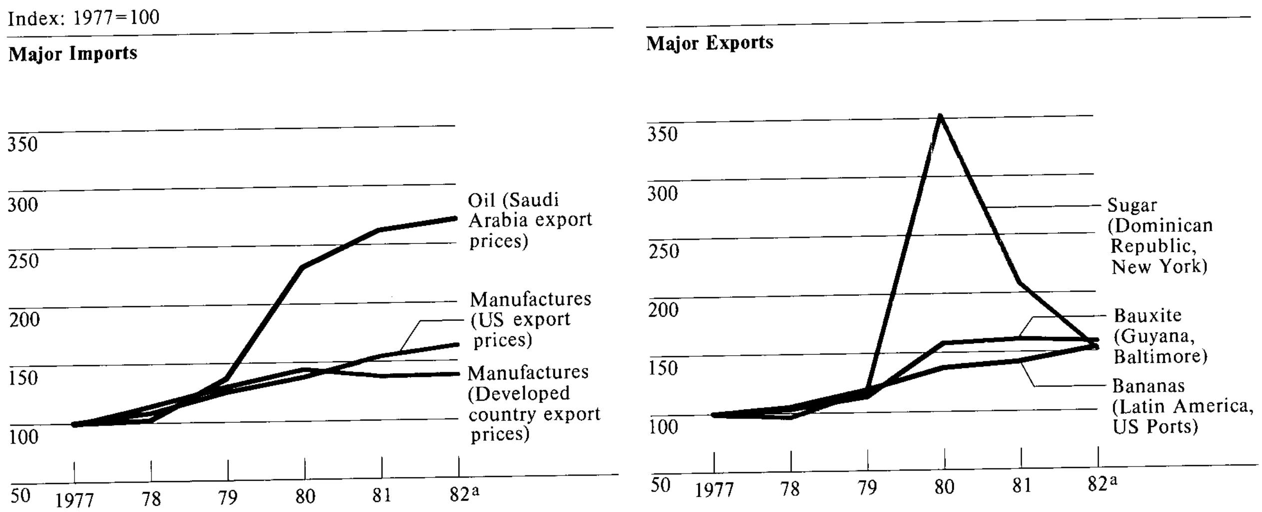
Caribbean Trade Price Indexes



[a] January-June.

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In addition, the production of key export commodities has declined due to adverse weather, labor problems, and industrial bottlenecks. The region has not fully recovered from devastating hurricanes in 1979 and 1980. As a result, banana production in the Eastern Caribbean, a source of as much as 43 percent of export earnings in some countries, has yet to regain 1979 levels. Sugar production for the Caribbean as a whole fell by some 9 percent in 1981, largely a result of bad weather, crop disease, and rapidly rising production costs.

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Role of External Financing

Caribbean countries have continued to rely heavily on external financing to keep their economies afloat during the recent downturn. The net inflow of direct investment, loans, and official grants has risen from $1.3 billion in 1977 to an estimated $1.5 billion in 1980 (excluding the three French Overseas Departments in the region). These resources, however, have fallen relative to external financing requirements: between 1977 and 1981 the sum of current account deficits and official debt amortization soared from $393 million to $1.8 billion. For 1982 net resource flows are projected at slightly over $1.5 billion compared with financing requirements of $2.0 billion.

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Grants and concessional loans provided 50 percent of total resource inflows in 1980, with 70 percent of this assistance coming from bilateral sources. The role of multilateral institutions in the external financing of Caribbean countries has been expanding. Between 1977 and 1981 loan approvals to the region by the Inter-American Development Bank rose from $90 million to $206 million, while approvals by the fledgling Caribbean Development

The Economic Situation in Individual Countries

Barbados' real GDP fell 3 percent in 1981. Setbacks in the main economic sectors—sugar, other agriculture, tourism, and manufacturing—because of adverse weather conditions, labor disputes, and weak external demand were major factors. Official external debt more than doubled in 1981, reaching $164 million. Barbados has implemented tax relief to encourage further investment and continues to focus on export promotion to foster economic growth. The Central Bank has tightened credit conditions to help ease balance-of- payments and inflationary pressures. Tourism continues to falter and we expect zero real economic growth this year.

Haiti's real GDP fell 2.1 percent in 1981. The plunge in economic activity was largely attributable to declines in coffee, sugar, and bauxite production. Earnings from coffee, Haiti's largest export, fell by two-thirds to $30 million. Although external debt in 1981 totaled $320 million, debt service was only $20 million because of Port-au-Prince's access to concessional loans. The Haitian Government continues to encourage export-oriented firms through various incentives. The slight economic pickup in the United States and the EC during second-half 1982 and more stringent controls on imports should hold the current account deficit to no more than last year's $116 million. However, the cost will be near zero real GDP growth this year.

The Dominican Republic's rate of real GDP growth fell from 5.4 percent in 1980 to 3.4 percent in 1981 and will probably slow somewhat further this year. Unemployment currently exceeds 25 percent. Exports this year are expected to be 30 percent below the 1981 level while imports are projected to fall by 15 percent. The new government intends to liberalize foreign investment laws to attract badly needed foreign capital. The central bank is allowing interest rates to rise to encourage domestic saving.

Jamaica managed a 1.5-percent increase in real GDP growth in 1981 after seven years of decline, but external debt rose to $1.4 billion by yearend. Foreign exchange earnings are being hurt by falling sugar production and slow bauxite export growth. Tourism is beginning to pick up but is still below 1979 levels. Economic policies to cope with the current account deficit center around increased allocations of foreign exchange for raw material imports for industry and a renewed emphasis on export promotion. Nevertheless, we believe the current account deficit will widen to $550 million this year, with the economy registering just under 2-percent growth.

Guyana's economy is in critical condition. Real output fell by 6 percent in 1981, putting real per capita income nearly 30 percent below the 1975 level, while external debt rose to $635 million. Poor performance in the bauxite and sugar industries have been a major reason for the worsening economy. In an effort to cope with deteriorating economic conditions, authorities have been laying off public-sector employees and trying to improve government efficiency. The government has increased consumption taxes and raised interest rates to encourage saving. To spur export activity, Guyana is allowing more private-sector independence in manufacturing and agriculture. Even so, real GDP will probably decline another 10 percent this year.

Among the other Caribbean countries, only St. Vincent—with a 9-percent increase in real GDP—avoided a growth slowdown in 1981. Even Trinidad and Tobago witnessed a plunge in growth despite its profitable oil industry that was largely responsible for the country's $300 million current account surplus. Economic policy in most of these countries has been directed toward monetary and fiscal restraint in an effort to bring current account and budget deficits under control.

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Bank climbed from $30 million to $48 million. World Bank loan commitments have almost trebled since 1977, reaching $134 million last year. [redacted]

Other economic assistance, including OPEC and Communist disbursements, has been relatively small. The Caribbean received only $75 million from OPEC—mostly from Venezuela—between 1975 and 1980; $45 million of this went to Jamaica and $20 million to Guyana. Communist aid over the same period reached about $50 million, with the lion's share going to Guyana and Jamaica. [redacted]

Direct investment has played an important development role, contributing 20 to 30 percent of total financial inflows in recent years, according to World Bank estimates. The United States has been the single-largest source, with one-third share of the $9.2 billion OECD total direct investment in the region at yearend 1978, the last complete reporting year. The US share has fallen since then. Trinidad and Tobago, the Netherlands Antilles, and the Bahamas have been the major beneficiaries, accounting for 63 percent of Western direct investment in the region in 1978. Petroleum processing facilities have been the primary investment target in these countries. To a much lesser extent, private capital has been attracted to Jamaica, Suriname, and the Dominican Republic for the bauxite/alumina and tourism industries. [redacted]

Future Trends

We believe that the economic downturn in the Caribbean region will bottom out in 1983. Key elements in this outlook are stable oil prices, moderate economic recovery in OECD countries, and a related upturn in primary commodity prices. The performance of the combined Caribbean current account deficit next year will be driven to a large extent by developments in the Dominican Republic and Jamaica. Economic adjustment policies under way in these two countries are likely to take firmer hold next year, but only Santo Domingo is likely to reduce its current account deficit. For the Caribbean as a whole, the current account deficit should fall slightly from the 1982 level of $1.5 billion to around the 1981 figure of $1.3 billion. [redacted]

No major external financing problems are foreseen for the region in 1983. Bilateral and multilateral economic assistance will continue to bear the brunt of the external financing requirements, while grace periods on concessional loans received since 1977 will ease debt service requirements. Continuing foreign assistance should give the Caribbean countries some breathing space to pursue economic restructuring. [redacted]

[redacted]

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China: The Economy at Midyear [redacted] 25X1

Beijing is still struggling to restrain industrial growth, particularly in heavy industry. We believe the government reorganization has disrupted normal channels of economic control and communication, making implementation of this year's plan particularly difficult. Efforts to get managers to focus on energy conservation and improvements in quality and productivity have met with little success [redacted]

Heavy Industry's Unplanned Surge

Beijing is particularly concerned about the pickup in heavy industry, which is outpacing light industry and sidetracking "readjustment" policies. Heavy industry's rapid growth for four successive quarters has raised production to a new record level, 10.7 percent above the low point of a year ago. The unforeseen boom in heavy industry, where growth of only 1 percent was planned for 1982, has caused energy shortages in key industrial centers in east and northeast China. Energy production, especially coal, grew rapidly in the first six months, but failed to keep up with heavy industry's growth. As a result, the State Council in May issued new regulations restricting the output of energy-intensive factories and tightening control over electricity allocation. [redacted]

The need to curb industrial energy consumption—which was planned to drop by 3 percent this year—was a major theme of a July speech by Zhang Jingfu, head of the State Economic Commission, to a national industry conference in Beijing. Referring to strains in the energy supply system, Zhang reported that "electricity was overgenerated, the volume of rail freight was excessive, and coal stored in many localities was used up." [redacted]

Zhang and Premier Zhao Ziyang, who also addressed the conference, emphasized that too-rapid growth hinders efforts to improve efficiency, a point Beijing has made repeatedly in recent months. Production costs in state enterprises were down by 0.2 percent in the first five months, falling short of the planned cut of 1 to 2 percent. Both Zhang and Zhao restated Beijing's threat that enterprises not meeting energy consumption and 25X1
productivity targets will be closed. [redacted]

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Light Industry Curtailed

Light industrial production has declined from the peaks of late 1981, but production in the second quarter was still 6.8 percent above the year-earlier level—high enough that the 7-percent growth target for 1982 remains within reach. Part of the recent decline is due to the fact that some local authorities are using for heavy industry materials, energy, and transport that had been earmarked for light industry. The decline in overall light industrial production also has occurred in part as a response to large inventory buildups. Although retail sales rose 9.2 percent in the first five months, inventories of unwanted goods continued to rise in the first six months, as consumers in both urban and rural areas became more selective in their 25X1
purchases. In March the State Council ordered cutbacks in the production of consumer durables outside the plan. The cuts were aimed specifically at new producers turning out poor quality goods. [redacted]

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Foreign Trade

The conservative policies of the past year remain in effect in the foreign sector. We estimate that 25X1

China: Industrial and Energy Production

	1981	1982		1982	
		Chinese Plan	CIA Forecast	1st Qtr	2nd Qtr
	Index: 1977=100, seasonally adjusted				
Total Industry	**139.4**	**145.0**	**147.5**	**148.8**	**149.1**
Heavy	120.3	121.5	125.7	127.9	129.9
Light	164.1	175.6	175.6	175.3	173.0
Energy	112.2	112.5 [a]	116.4	116.7	117.7
	Percent Change [b]				
Total Industry	**4.1**	**4.0**	**5.8**	**7.6**	**0.8**
Heavy	−4.7	1.0	4.5	11.9	6.7
Light	14.1	7.0	7.0	−12.2	−5.2
Energy	−0.6	0.3	3.8	8.9	3.7

[a] Estimated.
[b] Percent change over previous period at an annual rate.

[redacted]

imports in the first six months were cut by 15.4 percent from last year's pace, while exports were up by 11.9 percent. The growing trade surplus has been used to push foreign exchange reserves up to record levels and to reduce debt; China's debt service ratio has dropped to about 5 percent. [redacted]

Grain imports, however, are running ahead of last year, reflecting low prices. More than one-half are still coming from the United States. In May, Canada announced a new three-year agreement to supply China with 3.5-4.2 million tons of grain per year. [redacted]

Of the 45 foreign oil companies that participated in seismic surveys,.33 submitted bids on 17 August for offshore oil exploration. More negotiations will be needed before contracts are signed. Some companies did not submit bids because of concern that Chinese taxes and Beijing's share of crude oil output will be too high to allow adequate profits, and that requirements for technology transfer are excessive. [redacted]

Agriculture

The 1982 summer grain harvest was about equal to last year's. Major fall crops are doing well, and we expect production to remain at or slightly above last year's level. Grain output will approach, but probably will not attain, the target level of 333.5 million tons. [redacted] 25X1

The Budget and Capital Spending

Beijing managed to post a budget surplus in the first half, aided by the larger-than-expected revenues from heavy industry. Zhang Jingfu, nevertheless, expressed concern that the deficits that appeared in May and June portend fiscal difficulties for the second half. These deficits probably were caused by a combination of declining revenues in other sectors and rising expenditures for capital construction. [redacted] 25X1

Despite attempts to restrain investment spending, outlays for capital construction were up 30 percent. 25X1 Data for the first four months show off-budget investment running 70 percent ahead of last year, in contrast to the 8-percent budgeted increase. [redacted] 25X1

Economic Controversy

The unplanned surge in heavy industry and investment serves as a reminder that Beijing's policies still encounter resistance, especially at the local level. Beijing repeatedly has called for slower growth to allow plant managers to focus on improving productivity and quality, but lower level officials and managers continue to resist. Rapid growth remains a major objective, especially since profits and bonuses of the enterprises they manage remain closely linked to output. [redacted] 25X1

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Controversy over economic problems may become increasingly apparent at the 12th Party Congress and the National People's Congress later this year.

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Investment, the rate of growth, the role of light industry, and foreign economic relations all remain unsettled issues. 25X1

The Chinese press has also been full of "plan versus market" discussions. We believe opponents of Vice Chairman Deng Xiaoping are attempting to discredit his leadership by citing problems with the market-type reforms introduced over the past three years. This issue, as well as the campaigns now under way in China to combat foreign influence, the anticorruption drive, and politicking related to the upcoming congresses could affect the overall economic climate. 25X1

Outlook for 1982

The energy situation and Beijing's continuing efforts to improve efficiency will dominate the economic picture for the rest of the year. Heavy industrial growth will be slowed by the energy crunch, but the growth targets set forth in the 1982 plan will probably be met or surpassed by the end of the year. We believe the central authorities' efficiency goals will not be met, however, because managers are still concentrating mainly on raising output. Budget constraints and continued shortages of many consumer goods will prevent much of an increase in living standards. If Beijing is unable to restrain production in heavy industry, consumer goods output may decline, further complicating the effort to raise living standards. 25X1

Beijing will begin to restrain export growth and step up imports, especially of industrial supplies. Nevertheless, we estimate this year's trade surplus will reach a record $5 billion. Proceeds from the surplus will be used to reduce debt and increase foreign exchange reserves. Beijing is also likely to use more of its foreign exchange earnings for capital imports and investment abroad, especially in Hong Kong. 25X1

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