Private Debt Finance for Developing Countries

In 2003, net private debt flows to developing countries strengthened markedly. The 2003 net inflow of $51 billion compares favorably with the net inflow of $3 billion in 2002 and a net outflow of $28 billion in 2001 (table 2.1). The recovery in net debt flows mirrored an increase in gross debt financing from bonds and syndicated loans, which was 34 percent higher in 2003 than 2002. It was led by a jump in new bond issuance, from $56 billion in 2002 to $86 billion in 2003 (figure 2.1 and table 2.2). Short-term lending, including from commercial banks, also increased strongly, but this increase was heavily concentrated in a few countries, mainly in Europe and Central Asia.

Low yields on alternative investments in developed countries—coupled with better credit quality in emerging markets and a keener appetite for risk among investors for much of the year—encouraged a greater supply of external financing in 2003. Moreover, 2003 saw none of the major financial crises that in the past have precipitated a sudden contraction in bank lending or an interruption in bond issuance. Structural changes in the banking industry continued to exert a moderating influence on lending, although bank lending was probably particularly sensitive to improved perceptions of credit quality.

Demand for external finance continued to be restrained by improved saving-investment balances in many emerging-market countries. That restraint reflects a desire in developing countries to limit leverage. But it also reflects the development of domestic sources of finance, including deeper domestic capital markets. This has been mirrored in the large current account surpluses run by several developing countries and further increases in already high rates of reserve accumulation. Overall these adjustments have resulted in significant improvements in the external liability positions of developing countries, which have been a factor in recent credit-rating upgrades.

Strong liquidity and only modest increases in demand for capital lie behind the major decline in the premiums demanded by investors for taking on developing-country credit risk. The average spread on emerging-market bonds (EMBIG) fell from 725 basis points at the end of 2002 to just 390 basis points at the end of January 2004—its lowest level since 1997—before climbing again to 420 basis points by mid-February. This compression in emerging-market spreads may, however, have outstripped the fundamental improvement in credit quality. It will be difficult for investors in emerging-market debt to match the very strong returns they have achieved recently. There are signs that emerging-market bond spreads have recently become very sensitive to expectations about the course of monetary policy, particularly in the United States.

Table 2.1 Net debt flows to developing countries by region, 2000–03

<table>
<thead>
<tr>
<th>Region</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>–3.9</td>
<td>–28.1</td>
<td>3.2</td>
<td>50.6</td>
</tr>
<tr>
<td>Disbursements</td>
<td>194.0</td>
<td>198.3</td>
<td>202.8</td>
<td>210.3</td>
</tr>
<tr>
<td>Amortizations</td>
<td>188.8</td>
<td>203.6</td>
<td>201.0</td>
<td>191.7</td>
</tr>
<tr>
<td>Short-term, net</td>
<td>–9.1</td>
<td>–22.9</td>
<td>1.4</td>
<td>32.0</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>–24.7</td>
<td>–11.3</td>
<td>–3.1</td>
<td>9.4</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>21.1</td>
<td>0.1</td>
<td>22.7</td>
<td>36.0</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>1.4</td>
<td>–14.1</td>
<td>–20.6</td>
<td>9.3</td>
</tr>
<tr>
<td>Middle East and N. Africa</td>
<td>–3.4</td>
<td>2.0</td>
<td>3.8</td>
<td>–5.7</td>
</tr>
<tr>
<td>South Asia</td>
<td>2.9</td>
<td>–2.8</td>
<td>2.8</td>
<td>–1.7</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>–1.3</td>
<td>–2.0</td>
<td>–2.2</td>
<td>3.4</td>
</tr>
</tbody>
</table>

There was some progress in 2003 in strengthening the overall financial architecture, with the widespread acceptance of collective action clauses in new bond issues. But a substantial stock of bonds remains without such clauses. Efforts also continued to revise the Basel Capital Accord to bring the capital that internationally active banks must hold into better alignment with the risks inherent in different types of lending.

The recovery in private debt flows and narrowing of bond spreads continued amid increasing evidence of a turnaround in the business cycle in industrialized countries. The turnaround pushed long-term interest rates higher, potentially reducing the attraction of investing in developing-country debt. This suggests that private debt financing is likely to grow only moderately in 2004. At the same time, the availability of funds is likely to be strongly influenced, as in the past, by investors’ perceptions of developing countries’ credit risk. Countries’ demand for funds should rise with stronger economic activity.

But important risks remain. Further increases in interest rates in advanced economies could dampen flows, and some correction in spreads is possible. Renewed volatility in the financial markets—likely stemming from imbalances in the advanced economies—may also have an adverse impact on flows. And the handling of the restructuring of Argentine debt could have an important influence on investor attitudes.

The recent improvement in the terms on which financing is available to developing-country borrowers provides an opportunity for refinancing and debt management. Some developing-country borrowers have already taken advantage of that opportunity. But it is important that borrowers heed the lessons of recent years and remain prudent about incurring additional external liabilities. Particular care should be taken to ensure that foreign-currency liabilities are appropriately hedged. Moreover, borrowers should beware of possible future fluctuations in the availability of finance, particularly in light of the renewed pick-up in short-term financing.

### Conditions affecting the supply of funds

A combination of low yields in developed countries and greater appetite for risk among investors in 2003 played a significant role in augmenting the supply of capital and in channeling more of that capital to developing countries. In particular, bond issuance jumped an impressive 53 percent over 2002. The increase in bond issuance accounted for all of the increase in net long-term private-source debt flows and 43 percent of the increase in total private debt flows (including short-term) in 2003. Moreover, changes in the external financing environment had more of an impact on bond financing than on bank lending,
as bonds are tradable assets and thus provide investors flexibility to adjust their risk exposure more easily and swiftly than in other sectors of capital markets.

Average long-term yields in Europe, Japan, and the United States, which had been edging down in 2002 due to economic weakness, declined further in the first half of 2003, reaching their lowest level in 50 years before beginning to turn around late in the year (figure 2.2). The decline provided an incentive for investors to allocate funds into higher yielding developing-country debt, as previous declines had done over the past decade. Increasingly developing-country investments have joined the mainstream. Investors have moved funds in and out of developing countries opportunistically, substituting assets in developed countries for developing-country investments, rather than remaining faithful to the asset class. Though most investors in the class have a relatively long investment horizon, emerging-market debt funds thus remain potentially volatile. In 2003, the average long-term (10-year) government yields on developed-country debt declined to 2.9 percent from an average of 3.5 percent in 2002. Yields on developing-country debt declined as well, but, at an average rate of 9.1 percent, they continued to provide investors an opportunity for substantial returns over developed-country debt, albeit at a higher risk.

Debt flows to developing countries have seldom been motivated purely by nominal rates of return, particularly since the mid-1990s. Credit risk concerns—or perceptions of risk, which are influenced by the overall risk sentiment in capital markets—have had an important influence as well (see Global Development Finance 2003). Developing-country debt, for much of its history, has been highly sensitive to events, positive and negative. The value of that debt has fluctuated widely, as demonstrated by a statistical analysis of the distribution of daily changes in benchmark risk premiums (figure 2.3). A significant part of the distribution of developing-country spreads lies far outside the boundaries of a normal distribution that might be achieved with the same mean and variance. In other words, it has a “fat-tailed” distribution. This implies that developing-country debt is inherently more risky than the usual alternatives. Accordingly, changes in risk perceptions in the external financing environment have played a disproportionately strong role in influencing capital flows to developing countries.

Alongside the incentive of higher returns, crucial factors shaping investors’ portfolio-allocation decisions have been the perception of the credit risk associated with developing countries and investors’ overall appetite for risk. Both improved in 2003. The perception of lower credit risk has come about as investors have lowered their expectation of

Figure 2.2 Yields on debt to developing and developed countries, 1990–2003

Note: Developing-country yields refer to yields on benchmark emerging-market bond indexes and developed-country yields refer to average of long-term (10-year) benchmark government yields for the United States, Europe, and Japan. Sources: Bloomberg, J.P. Morgan Chase, and World Bank staff calculations.

Figure 2.3 Distribution of daily change in spreads, Jan. 1998–Oct. 2003

Source: World Bank staff calculations based on J.P. Morgan Chase data.
systemic risk associated with developing-country debt. The investor base for developing countries is now more diversified, keeping in check the herd mentality. More investors now treat developing-country investments as part of a more diversified portfolio that provides a better buffer during times of stress—in part due to the depth, breadth, and liquidity of the mature markets in which such portfolios can be traded. Increasing mainstreaming of developing-country investments also reduces volatility, as investment allocations are made more strategically (for example, by risk-allocation committees of investment funds) and with a long-term investment horizon. In the early 1990s, by contrast, the investor base consisted mainly of specialized investors who focused primarily on developing countries. Those investors aimed to minimize the misalignment of their own portfolio’s performance against those of their peers, an effort that often led to a simultaneous and extreme fluctuation of expectations that greatly affected the availability of capital for developing countries.

Joint efforts by the international financial institutions, capital market participants, and developing countries to strengthen the overall financial architecture and the flow of information also have helped to support investor confidence. Those efforts have resulted in the adoption of sounder economic policies, as well as in greater transparency in the liability positions of many developing countries. More research is being done by investors and promoters of developing-country debt. Many more developing countries currently carry ratings by independent credit rating agencies than during the early 1990s. Moreover, changes in the ratings have become much more congruent with changes in countries’ economic fundamentals and their prospects for external financing.

The string of crises since the mid-1990s exposed vulnerable spots in developing-country debt markets. Together, the countries that have experienced crises have accounted for almost 60 percent of the outstanding private-capital debt stock of developing countries. That market-based financing continues to be available to developing countries indicates that investors have acknowledged the risky nature of those investments and are finding ways to cover their exposure—for example, through the credit derivative market. Finer distinctions among countries’ creditworthiness, in great part due to better research and information, have reduced the probability of shocks rippling with the same intensity through the entire credit spectrum and across countries. The probability that investors’ asset values will be preserved has therefore increased. The impact of successive shocks on developing-country debt prices and the quantity of new debt acquisition both have been lower in recent years than in the late 1990s, when spikes in risk premiums were typically more intense and interruptions to capital-market access more frequent and prolonged. The average of the peaks in the developing-country risk premium during the crises in Turkey (2000), Argentina (2001), and Brazil (2002) was about 900 basis points, much lower than the average of about 1,550 basis points during the Mexican (1994) and Russian (1998) crises.

Further statistical analysis indicates that episodes of contagion resulting from a simultaneous deterioration of investors’ expectations (as opposed to that warranted by countries’ macroeconomic fundamentals), and the severity of those episodes, have decline over time (table 2.3).

Table 2.3 Declining severity of contagion over time

<table>
<thead>
<tr>
<th>Crisis</th>
<th>Analysis period</th>
<th>Variation explained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Jan. 2001 – Jun. 2001</td>
<td>0.27</td>
</tr>
<tr>
<td>Brazil</td>
<td>Nov. 1998 – Dec. 2000</td>
<td>0.54</td>
</tr>
<tr>
<td>Brazil/Turkey</td>
<td>Jan. 2002 – Aug. 2002</td>
<td>0.27</td>
</tr>
<tr>
<td>East Asia</td>
<td>Sep. 1997 – Feb. 1998</td>
<td>0.70</td>
</tr>
<tr>
<td>Mexico</td>
<td>Dec. 1994 – May 1995</td>
<td>0.69</td>
</tr>
</tbody>
</table>

Note: Developing-country spreads have often shown systematic co-movements, especially around shocks. Statistical characteristics of the spread data for various countries taken as a set can be used to analyze market conditions and the impact of shocks. Increases in spreads across the board after an adverse localized shock that should not warrant ripple effects across countries suggest signs of contagion. The statistical technique of principal component analysis enables an estimation of the impact of the implicit underlying variables that are assumed to influence the joint dynamics of the dependent variable (in this case the set of spreads). This technique transforms a set of systematically correlated variables (spreads) into a set of uncorrelated variables that possess explanatory power for the dependent variable and are ranked by reducing variability. The first principal component (FPC) explains the greatest amount of variation, or dispersion from the mean, in the dependent variable. In the above analysis, the declining value of variation being explained by the FPC over time suggests that an increasingly smaller portion of variation in the change in spreads can be attributed to one combination of implicit underlying explanatory variables. Instead, the explanatory power is being increasingly spread out over a variety of factors. This suggests that the severity of contagion from a particular event may be declining, as investors increasingly differentiate risk across countries.

Source: World Bank staff calculations.
The proportion of variance in daily changes in developing-country spreads that can be attributed to particular shocks (measured by first-principal-component analysis) is much lower in recent years than it was until the late 1990s.

In 2003, the recovery in corporate profitability and economic growth in developed countries helped ease investors’ risk aversion (figure 2.4). A reduction in the overall level of uncertainty associated with the future course of business and the economic environment has often helped spur investor appetite for risky assets. One implicit measure of risk appetite, the Liquidity, Credit, and Volatility Index (LCVI) (box 2.1), indicated a higher investor tolerance for risk in 2003 than in 2002. Its components showed that liquidity in the markets improved more or less continuously throughout 2003. Despite periods of volatility in capital markets due to interest-rate uncertainties in the United States, the heightened liquidity provided high-risk borrowers, including developing countries, with fertile fields for new financing.

Of particular importance was the improvement in investor sentiment toward developed-country high-yield debt, as investors in such debt are also a significant source of funds for developing countries’ debt (figure 2.5). Although spreads on high-yield debt historically stayed below the developing-country spreads, investor sentiment in this sector had suffered since 2000 due to high rates of bankruptcy, corporate failures, and low profitability, all of which drove up the high-yield risk premium in 2002 to its highest levels since the early 1990s—nearly 1,100 basis points. Combined with reduced fears of contagion and systemic crisis in developing-country debt, the improved attitude toward risk has reinforced the incentive of yield differentials between developed and developing countries and encouraged investments in developing-country bonds.

**Conditions affecting the demand for funds**

Since the crises of the late 1990s, several adjustments to domestic economic balances have reduced demand for external finance. These adjustments in many cases reflect a reduction in debt leverage, particularly in the corporate sector, and increasing reluctance of borrowers to expose themselves to the risks of borrowing in foreign currency. Domestic investment rates have also fallen in some regions.

Of equal importance has been the development in recent years of deeper domestic capital markets in countries such as Brazil, Chile, Hungary, India, the Democratic People’s Republic of Korea, Malaysia, Mexico, Poland, South Africa, and Turkey. Apart from helping reduce their dependency on external finance—and thus their exposure to exchange-rate and liability mismatches—the development of local bond markets serves several functions—among them mobilizing domestic savings, providing an operational tool for economic management policies, and setting benchmarks for a
Box 2.1  General risk appetite and sentiment toward developing countries

Developing-country investments have entered the investment mainstream, becoming a small part of many investors’ portfolios, rather than a stand-alone asset class dominated by investors focused exclusively on developing countries. With this shift, the overall appetite for risk in various segments of the capital markets has become an important driver of developing-country capital flows. Because wealth effects and uncertainties unrelated to developing countries can affect the overall investor risk appetite, they can affect the terms of new funding as well. Indeed, periods of heightened investor risk aversion have coincided with higher developing-country risk premiums.

Isolating changes in the riskiness of an asset from changes in investors’ general appetite for risk remains cumbersome, partly because of interlinkages in capital markets and partly because of the statistical issue of endogeneity. However, observations of coincidental trends in statistical measures across various capital-market segments can provide a sense of the changing preferences of investors for risky assets.

One leading measure of implicit investor risk sentiment is the Liquidity, Credit, and Volatility Index (LCVI) of J.P. Morgan. The LCVI attempts to capture changes in investors’ overall risk attitude through measures of liquidity, volatility, and credit risk. It is an equally weighted average of U.S. swap spreads, benchmark and off-the-run U.S. Treasury spreads, the degree of rank correlation between the performance of countries’ currencies and their interest rates, foreign-exchange market volatility, U.S. corporate high-yield spreads, emerging-market spreads, and implied volatility of stocks. By monitoring variables across several debt, foreign-exchange, and equity markets, the index is able to pick up indications of overall investor sentiment. Since 2000, it has been positively correlated (coefficient of 0.62) with developing countries’ benchmark spreads, indicating that increases in general investor risk aversion have coincided with increases in developing-country spreads. In 2002, amid growing uncertainty about the military conflict in Iraq and political and economic uncertainties in Brazil and Turkey, the LCVI spiked, followed by a swift decline in risk aversion starting in October 2002. In 2003, overall risk appetite increased in relation to 2002, with short periods of lower appetite. Increases in interest-rate uncertainty in the United States on the back of its economic recovery raised volatility in capital markets and led to spikes in the LCVI in mid- and late 2003. However, the benchmark spreads on developing countries weathered these episodes of heightened volatility, although new bond issuance declined between June and August 2003 as borrowers avoided issuance under turbulent pricing conditions.
reform has played an important role in developing domestic markets in several countries, particularly in developing a large local institutional investor base. Domestic markets have provided borrowers with access to financing in local currency, important for borrowers operating in the nontradable sectors and for sovereign issuers seeking to avoid currency risk. In 2003, companies such as Mexico’s Coca-Cola, FEMSA, and Cemex found it advantageous and possible to raise even quite large loans by issuing bonds in domestic markets, reducing their need to draw on international markets.

**Improved external liability positions and rating upgrades bolster investor sentiment**

Better credit quality in developing countries in 2003 translated into better credit-risk ratings. Rating upgrades (and improved economic prospects) in certain developing countries that had experienced substantial economic and financial difficulties recently (Brazil, Pakistan, the República Bolivariana de Venezuela, the Russian Federation, and Turkey), were particularly important in influencing investor sentiment. As upgrades exceeded downgrades, the overall creditworthiness of developing countries, proxied by their sovereign ratings on Moody’s rating scale, increased to its highest level since the beginning of 1998 (figure 2.6). Average credit quality based on ratings of countries on the Standard and Poor’s rating scale also showed an improvement in 2003. However, overall creditworthiness measured on Standard and Poor’s ratings was more conservative, and the improvement in credit quality somewhat lower, than those based on Moody’s ratings, as has generally been the case since 1998. Changes in ratings reflect progress on several domestic fronts, including the ability to service external debt, stability in the political and economic climate, prospects for economic growth, and increasing resilience of several countries to external shocks. But concern over the sustainability of public-debt positions in some countries continues. In contrast to developing countries, global credit quality was down for most of 2003, although the pace of decline eased as the year progressed. It is not clear that the general trend toward rating upgrades will be maintained. Standard and Poor’s recently indicated that it expected downgrades to exceed upgrades over the coming year in Latin America.

Credit quality varied across regions. The average rating for Latin America (B1) remained the lowest of all regions—almost two notches below the developing-country average of Ba2. By contrast, average credit quality in Europe and Central Asia (Ba1) reached its highest point since 1997. Credit quality in East Asia (Baa3, the investment-grade threshold on the ratings scale) continued to nudge up, building on improvements since 2001.

One factor contributing to the improvement in investor sentiment and the tendency toward ratings upgrades is the fall in net external debt of developing countries since the late 1990s. Many developing countries have also built up substantial reserves (figure 2.7).

Despite a jump of almost $93 billion in total developing-country debt in 2003 (in part due to cross-currency valuation effects due to the decline in the exchange rate of the U.S. dollar against other major world currencies), the total external debt of developing countries declined to about 37 percent of their gross national income (GNI), compared with 44 percent in 1999.

Short-term debt, against which countries must maintain adequate liquidity, fell from 19 percent in 1997 to about 14 percent of the total outstanding debt in 2002, before increasing again to 15 percent in 2003 (table 2.4). Over the same period, the level...
of developing-country international reserves, measured as a ratio of their outstanding short-term debt, jumped from about 1.5 to 3.5—a much thicker buffer to deal with potential external shocks. In 2003, international reserves were high enough to cover imports for six months, compared with four months in 1997. Overall, the sources of foreign-exchange revenue, critical to servicing external debt, are better matched with the total debt burden of developing countries. For example, the total debt stock as a percentage of developing-country exports of goods and services was around 98 percent in 2003, compared with 130 percent in 1997.

External liability positions, however, vary widely by developing region. The total external debt of East Asia declined to 26 percent of the region’s GNI in 2003 from 40 percent in 1998. As a whole the region is maintaining international reserves worth nearly five times its short-term debt, compared with an average of three and a half times for all developing countries. By contrast, the total debt stock of Latin America and the Caribbean and of Europe and Central Asia has increased from the late 1990s. However, these regions are maintaining higher international reserves to cover their short-term liabilities.

Although the net external liability positions of many developing countries have improved markedly in recent years, the issue of public debt has been receiving increasing attention from analysts and investors. Public debt has increased markedly across a broad range of emerging-market economies in recent years, largely reflecting movements of interest and exchange rates on existing debt, the recognition of off-balance sheet and contingent liabilities, and the recapitalization of banking systems in some countries. Primary fiscal balances have typically weakened somewhat since the 1990s in most regions and have not offset the impact of other factors on public debt-to-GDP ratios. Public debt now averages about 70 percent of GDP in emerging-market economies, with the progress made as a result of large privatization programs in the first half of the 1990s having been reversed in many regions (IMF 2003). There have been defaults, or restructurings of distressed public debt, in Argentina, Ecuador, Pakistan, the Russian Federation, Ukraine, and Uruguay. In the light of the typically low level and high volatility of public revenues and the structure of public debt—with a relatively high proportion of debt external or linked to foreign exchange rates and domestic debt typically relatively short-term—the sustainable ratio of public debt-to-GDP in emerging markets may be somewhat lower than is normal in developed countries.

Ongoing structural change in financing

The pattern of external financing for developing countries has changed greatly over time and especially in recent years, following a string of financial and economic crises in the 1990s. Bond financing has grown from its roots in distressed commercial bank debt to become a major, albeit volatile, source of financing. In addition, structural—and strategic—changes in the international banking system have occurred during the same period.
Since the financing pattern in 2003 reinforced these changes, a brief historic review helps put into perspective the recent developments in bond and bank flows to developing countries.

Historically, bank lending and bond financing have alternated in providing financing for developing countries. After cycles of default on external debt (primarily bond debt) during the 1820s, 1870s, and 1930s, growth in debt financing during the 1970s was driven primarily by bank lending. Faced with high crude oil prices, most developing countries ran sizeable current account deficits (averaging 1.2 percent of GDP during the 1970s, excluding the Middle East and North Africa). At the time, commercial banks were awash with liquidity from the revenues of oil-exporting countries. Slow economic growth in developed countries amplified the attraction of the higher returns available in developing countries, leading banks to take on sizeable exposures there. However, as real interest rates in major developed countries increased and commodity prices (a key determinant of foreign exchange revenue for many developing countries) declined, bank debt burdens in many countries became unsustainable, beginning a cycle of decline in credit growth in developing countries. Net long-term bank lending to developing countries fell dramatically during the 1980s.

A second downturn in the credit growth cycle occurred after a period of credit expansion in the 1990s that was fueled by bond financing. The average annual rate of growth in the stock of bond debt in the 1990s was 23 percent, compared with 2 percent for bank lending (figure 2.8). Bond financing continues to fuel the current credit growth cycle for developing countries, as it did in the 1990s.

**Bond flows responded strongly to the external environment and domestic conditions**

Bond financing in 2003 was very responsive to changes in investor sentiment, as reflected in both the price and quantity of such financing. Bank lending, on the other hand, remained relatively subdued and stable.

**A sharp rally in bond spreads**

The combination of the stimulus from the external financing environment and the effects of domestic economic conditions in developing countries manifested itself strongly in a sharp decline in benchmark spreads for developing countries. The credit-default swap (CDS) spreads, which reflect the market-clearing premium for insurance against the probability of a country defaulting on its debt, dropped sharply in 2003, indicating an improvement in risk perception of developing countries (box 2.2). In a CDS contract the buyer is obligated to make to the seller periodic payments in exchange for the right to sell the underlying security at a pre-established value should a credit event occur during the life of the contract. Overall, CDS spreads for developing countries declined by almost 490 basis points in 2003—to 250 basis points from their peak of 736 in August 2002—indicating a significant drop in the implied probability of default (figure 2.9). The decline in spreads was accompanied by an equally strong drop in the volatility of CDS spreads to 13 percent in September 2003, from close to 50 percent in August 2002. CDS spreads for Asia, at 120 basis points, were the lowest of all regions, declining from 225 in August 2002. In comparison, spreads for Latin America were almost four times higher, at around 460 basis points. However, these spreads had contracted sharply from more than 2,000 basis points at the height of the uncertainty surrounding Brazil in 2002.

A sharp rally in bond spreads

Apart from the CDS market, which reflects transactions (as opposed to indicative prices sometimes used to estimate conventional spreads) and a longer term assessment of risk, investors’ strong...
Box 2.2 The developing-country credit-default swap market

Trading in the market in sovereign credit-default swaps increased markedly in 2003, after falling in 2002, as Argentina, which had been the second most active country in 2000, became inactive following its default in 2001. Emerging-market countries dominate the market for sovereign credit default swaps, with more than 90 percent of trading activity linked to such credits (Packer and Suthiphongchai 2003). Brazil, Mexico, the Philippines, and South Africa are the most active credits, followed by China and Colombia. The availability of an increasingly liquid credit derivative market has provided investors and lenders with greater flexibility to manage their risk exposures and ensure risks are borne by those most willing to do so. However, given the relative novelty of the market and the relatively light supervisory framework for some institutions, such as insurance companies, which are selling credit protection, concerns about the potential systemic consequences of a major credit event or events remain.

Several features in the spreads’ rally pointed to increasing sophistication of investors with regard to developing-country risk and a more seasoned approach by borrowers in contracting new debt.

The decline in developing-country spreads was spectacular on its own and by historic standards. Apart from the current rally, three other major episodes of spread compression can be identified since the early 1990s, when developing-country bond financing began to evolve. The decline in spreads through April 2003 (the first seven months of the rally) was by about 475 basis points, more than double the average degree of spread compression in the previous three episodes (figure 2.11). The fact that spreads declined sharply despite considerable uncertainty over global economic growth, the Iraq war, and volatile equity markets at the beginning of 2003 made the rally even more impressive.

Furthermore, the decline in spreads occurred for countries across all regions and across the
The most commonly used data on secondary-market spreads for developing countries comes from several emerging-market bond index (EMBI) series compiled by J.P. Morgan Chase. These market-capitalization-weighted indexes include U.S. dollar–denominated Brady bonds, Eurobonds, traded loans, and sovereign or quasi-sovereign local-market debt instruments for a range of emerging markets. The proportionality of instruments used in the indexes varies according to the overall composition of emerging-market debt at various points in history. These data provide a comprehensive picture of developing-country spreads but have some distinct characteristics:

- **Expanding country coverage.** As the universe of developing countries accessing capital markets has expanded over the years, various index series have evolved as well. The countries included in each successive index increased, rising from 8 in the early 1990s to 33 in 2002, before declining to 31 in 2003 (see timeline in the first figure below). Starting out with EMBI in 1990, the index evolved into EMBIG (for EMBI Global) was introduced in 1998. The credit risk embodied in various indexes has changed over time.

- **Reweighting.** The weights assigned to individual countries and instruments are reshuffled frequently due to changing country coverage, changing recommendations by the investment bank to investors on how to allocate portfolios most efficiently, and changes in the outstanding debt of countries. Occasionally the reweighting can have a significant impact on the overall level of spreads for developing countries, as when Argentina’s weight in EMBIG dropped from close to 16 percent before default (December 2001) to about 2 percent by 2003 (see second figure below).

- **Instrument coverage.** The mix of securities included in various indexes varies. For example, the recent EMBIG, apart from including international bonds (its largest component), also includes certain local-currency bonds and tradable loans. The original EMBI was composed primarily of Brady bonds.

- **Representative prices.** Occasionally, indicative prices have to be used. The prices recorded for various trades may not necessarily be an adequate representation of overall investor sentiment toward a particular country at a particular point in time.

These characteristics, apart from posing other limitations, complicate historical comparison of spreads at the aggregate level, as not all indexes go back to the same point in history. For example, by early October 2002, emerging-market spreads had widened to their second highest point since early 1999. It would appear at first glance that the rise in spreads was nowhere as high as it had been in previous episodes. However, among other things, the changes in weights assigned to countries included in the overall developing-country spread index should be kept in mind when comparing movements in spreads over time. A better perspective can be obtained by also comparing spreads for individual countries, preferably holding constant the financial securities whose prices make up the spreads for that country, as well as other variables.

### Box 2.3 Characteristics of developing-country spread measures

<table>
<thead>
<tr>
<th>Developing-country spreads, 1990–2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of countries in index</strong></td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>14</td>
</tr>
<tr>
<td>33</td>
</tr>
<tr>
<td>31</td>
</tr>
<tr>
<td><strong>Basis points</strong></td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>400</td>
</tr>
<tr>
<td>800</td>
</tr>
<tr>
<td>1,200</td>
</tr>
<tr>
<td>1,600</td>
</tr>
</tbody>
</table>

**Sources:** J.P. Morgan Chase.

<table>
<thead>
<tr>
<th>Comparison of spreads using fixed versus variable weights, 1998–2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basis points</strong></td>
</tr>
<tr>
<td>0</td>
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<td>500</td>
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<td>2,000</td>
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<tr>
<td>2,500</td>
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</tbody>
</table>

**Sources:** J.P. Morgan Chase and World Bank staff calculations.
entire spectrum of credit risk, albeit raising questions about the widespread effect of market liquidity (figure 2.12). Commensurate with credit risk patterns, spreads continued to differ across regions. Average spreads for Asia declined to 210 basis points by the end of 2003 from close to 300 basis points at the beginning of the year, while spreads for Latin America halved to around 500 basis points from almost 1,000 basis points. In terms of credit risk classification, spreads on investment-grade-rated countries declined from 272 to 185 basis points from the start to the end of 2003, while those for countries rated at the bottom of the credit spectrum dropped from 3,555 to 2,600 basis points.

The limited demand for new funds by borrowers, especially earlier in 2003, reinforced the rally in spreads. Because new bond issuance did not keep up with the sharp and swift increase in the supply of capital, investors sought to acquire developing-country debt through secondary-market trading in existing debt, driving up prices and further narrowing spreads.

And an incremental buildup in bond issuance

Since the late 1990s, borrowers have generally remained cautious about contracting new debt. Following the financial crisis of 1997–98, the East Asian countries adjusted their financing requirements to work with less debt; they have purposely avoided issuing bonds to the same extent as they did before the crisis. Borrowers in other regions have been periodically reminded of the risks of high international debt by the experience of countries that were major borrowers in the mid- to late 1990s and became victims of financial problems in recent years. The volatility in external financing conditions helped hasten the development of local bond markets, as did pension reforms. Most of the growth occurred after 1997, on the heels of the turbulent period experienced by developing countries in the international bond markets. Domestic capital markets have become an important source of corporate finance in East Asia and in some countries in Latin America.

Nevertheless, the decline in benchmark spreads provided enticing opportunities for all categories of borrowers to lock in new international debt at competitive terms, since secondary-market spreads influence pricing of new bond issues. Developing countries, however, did not immediately respond to the sharp decline in spreads with a flood of new bonds. Although new bond volume increased strongly in early 2003, the jump reflected pent-up demand from the interruption in issuance in late 2002 as the political uncertainties in Brazil and Turkey played out, as well as tarnished investor sentiment in the high-yield corporate sector in developed countries. Instead of a barrage of issues, which could have occurred given the strong investor interest, heightened liquidity, and declining risk aversion, bond flows to developing countries
increased gradually over 2003 (figure 2.13). Even more significant, borrowers lower down on the credit spectrum, those particularly vulnerable to shifts in investor sentiment, tapped bond financing under well-established market trends that generally favored borrowers.

Overall for 2003, bond financing for both sovereign and corporate-sector borrowers rose over 2002. Sovereign borrowers led the recovery in bond flows, accounting for almost two-thirds of the $44 billion bond issues by developing countries in the first half of 2003. But even sovereign borrowers showed a certain degree of prudence in acquiring new debt. Almost 60 percent of the sovereign borrowing was done by investment-grade-rated borrowers, those having the greatest capacity to adapt to changes in external financing conditions. Bond issuance by Mexico accounted for almost half of the total.

**Box 2.4 Evolution of markets for developing-country international bonds**

The now-thriving developing-country bond markets were born from distressed commercial bank debt. Led by Mexico in 1982, many developing countries had suspended payment on unsustainable bank debt by the late 1980s. In 1989, the U.S. Treasury, with the help of the International Monetary Fund and the World Bank, advanced the Brady plan. The idea was to restructure bank debt into liquid, tradable, and safe securities, the repayment of which (principal and sometimes interest) was secured against U.S. Treasury zero-coupon bonds that were to be held in a trust until the restructured bonds matured. In addition, countries were to undertake economic reform to work their way out of economic and financial stress. The restructuring resulted in Brady bonds worth $155 billion. Mexico was the first to issue them.

By the mid-1990s, 17 countries, mostly in Latin America, had implemented Brady-style debt exchanges. The debt restructuring of each country resulted in a unique array of Brady bonds, with two features in common. Creditors could exchange their loans for either “par” or “discount” bonds. The par bonds carried below-market interest but preserved the principal value of the debt. The discount bonds provided a floating interest rate but reduced the value of the principal by 30 to 50 percent.

Following the establishment of a liquid Brady bond market in 1989, investor confidence in developing countries gradually started to recover and grow, thus making possible the modern era of developing countries’ access to international bond markets and development of their domestic bond markets. Over time, those markets have grown in depth, breadth, and sophistication under the influence of the domestic economic situation in each country, the composition of their investor base, and international financial policies and frameworks. Although bond issuance by developing countries dates back to the early 1800s, its importance in the 1980s was minimal, averaging only about $3 billion per year between 1980 and 1989. After bond-market access for most Latin American countries was curtailed for a decade following the bank-debt crisis, the majority of issues came from East Asian countries. China and Malaysia accounted for almost 82 percent of the regional bond volume between 1983 and 1989. Hungary, the Russian Federation, and Turkey accounted for the bulk of the remaining developing-country bond market.

As investor confidence was still low, bond issuance was dominated by sovereign and public-sector borrowers, which accounted for almost 90 percent of bond issuance during that period.

The currency composition of bonds issued during 1983–89 suggests that Japanese and European investors were instrumental in supporting bond-market development for developing countries. While the U.S. market did absorb a significant portion of developing-country bonds until 1984, bond issuance in Japanese and European currencies...
Box 2.4  (continued)

accounted for almost 60 percent of the total developing-country bond issues during the 1980s. Most of the issues in the U.S. market were by borrowers that possessed an image of lower credit risk, especially those from Asia. Declining interest rates in the United States worked in favor of investors and borrowers, who capitalized heavily on floating-rate notes in expectation of further declines in interest rates. The U.S. role waned after 1989, as investors were saturated with exposure through Brady bonds and continued to smart from losses suffered on bank loans.

As more investors joined the ranks of the banks that were major holders of developing-country bonds in the early 1990s, developing-countries’ international bond issues gathered pace. Issuance increased from $4 billion in 1990 to a peak of $99 billion in 1997, with the number of countries issuing bonds increasing four times over the same period. The share of bond financing in developing countries’ total net private debt flows increased from 6 percent in 1990 to 46 percent in 1997. Many countries in Latin America re-established their access to bond markets, with the region as a whole accounting for almost 60 percent of developing-country bond issuance during 1990–97. With the growth in international bond markets, the size of the Brady bond market has been declining since the mid-1990s. Countries have been retiring their Brady bonds for the purposes of cost-effectiveness and liability management through swaps or buyback operations. Almost two-thirds of the original stock of Brady bonds—including all of Mexico’s—had been retired by the end of 2003 (see figure).

Between 1998 and 2002, developing-country gross bond issuance declined to an annual average of $60 billion (compared with a peak of $99 billion in 1997). A series of crises beginning with Thailand in 1997, followed by the Russian Federation (1998), Brazil (1999), Turkey (2000), and Argentina (2001), took a heavy toll. Periods of credit squeeze alternated with periods of abundance, often in reaction to short-term developments. The relative inexperience of investors with developing-country bonds, and the inherent riskiness of such investments, worsened shocks through contagion.

<table>
<thead>
<tr>
<th>Stock of Brady bonds issued and outstanding</th>
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</thead>
<tbody>
<tr>
<td>$ billions</td>
</tr>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>$ billions</td>
</tr>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>Mexico</td>
</tr>
<tr>
<td>Argentina</td>
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<tr>
<td>R.B. de Venezuela</td>
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</tr>
<tr>
<td>Uruguay</td>
</tr>
<tr>
<td>Dominican Republic</td>
</tr>
<tr>
<td>Costa Rica</td>
</tr>
<tr>
<td>Poland</td>
</tr>
<tr>
<td>Bulgaria</td>
</tr>
<tr>
<td>Czech Republic</td>
</tr>
<tr>
<td>Slovakia</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Nigeria</td>
</tr>
<tr>
<td>Philippines</td>
</tr>
<tr>
<td>Ivory Coast</td>
</tr>
<tr>
<td>Jordan</td>
</tr>
<tr>
<td>Vietnam</td>
</tr>
</tbody>
</table>

Sources: Bloomberg and various central banks.

of the total investment-grade issuance by sovereigns in the first half, with most of the remainder being from Chile, Hungary, Poland, and South Africa. A noticeable exception to the overall investment-grade setting was the return of Brazil, rated B2 (five levels below the investment-grade threshold), to bond markets after being shut out since early in 2002. Reportedly, institutional investors showed keen interest in Brazil’s bond issues. Strong participation by institutional investors in other countries’ bonds was also reported. Such investors typically have long-term investment horizons, which contribute to a relatively stable financing environment.

As signals of investor confidence became stronger, despite the economic uncertainties in developed countries, sovereign borrowers rated below investment grade came to account for a much larger share of total sovereign bond flows. The share of such borrowers jumped to nearly
PRIVATE DEBT FINANCE FOR DEVELOPING COUNTRIES

Bond financing for private sector borrowers grew gradually as a share of total developing-country bond issuance in 2003 (figure 2.15). Borrowers from Europe and Central Asia, Latin America, and South Africa accounted for almost all of the doubling in private sector bond financing in 2003 over 2002. Benign financing conditions facilitated access for corporate borrowers from several small and infrequent market participants, such as Bulgaria, Colombia, Estonia, and Kazakhstan. In addition, access conditions for the private sectors of Brazil, the Philippines, and the Russian Federation (countries recovering from financial crises) also improved. Corporate borrowing from Russia reached an all-time high, while that from the Philippines was close to its peak levels of the mid-1990s.

Despite the easing of the corporate sector’s access to bond financing in 2003, markets maintained a distinct tiering for credit risk, which was reflected in the pricing of new bonds. The difference in the average risk premium (the spread charged over the risk-free rate in primary markets when new issues are priced) between sovereign and public-sector bonds compared with private-sector bonds remained among the highest since 1995. While the average primary-market spread for sovereign borrowers (365 basis points) reached its lowest level since 1998, the average spread for private sector borrowers (near 500 basis points) was close to the 1990s peak (figure 2.16).

70 percent in the second half of 2003. There was a particularly large jump in issuance from Brazil, the Philippines, and the República Bolivariana de Venezuela, which accounted for more than half of all sovereign issuance from non-investment-grade-rated countries in the second half of 2003. Turkey, which had been an active borrower in the first half of 2003, remained active in the second half. Sovereign bond financing from these countries, all of which underwent financial and economic pressures not very long ago, was back up to levels close to the peaks of the 1990s (figure 2.14). Pakistan regained access to international capital markets with a $500 million bond issue in February 2004, less than five years after being forced to restructure previous bonds.
Announced new international bank loans increased slightly in 2003, compared with subdued levels in the previous two years. In 2003, new loans reached $95 billion, compared with $79 billion in 2002. The pickup in deals occurred mainly in Central Asia and Eastern Europe, with gross new lending at $29 billion in 2003, compared with $17 billion in 2002.

New loans to East Asia picked up only slightly to $24 billion from $21 billion in 2002. Even then, the 2003 figures were boosted by a $2.6 billion package to restructure the debt of a power project in Indonesia. New bank lending to Latin America edged up to about $22 billion.

Syndicated bank lending to the Middle East and North Africa was modest at just $7 billion in 2003, compared with an unusually strong $12 billion in 2002, when large loans for Saudi Arabia and Iran boosted the total. New loans to borrowers in Sub-Saharan Africa increased slightly to $8 billion in 2003, up from $6 billion in 2002. This was concentrated on borrowers from Angola, Ghana, Nigeria, and South Africa.

In Latin America, the public sector increased its share of new loans to 39 percent of the regional total in 2003 from 26 percent in 2002 and just 16 percent in 2001. The $9 billion raised by the Latin American public sector in 2003 included a $2 billion loan contracted by the Mexican government to help finance the retirement of its Brady bonds.

**Net bank lending turns positive**

New syndicated loans account for only a proportion of total bank lending, however, and not all of the commitments are typically disbursed immediately. Using a more comprehensive measure, including short-term flows, net bank lending turned positive in 2003 (table 2.5). Despite the increase in commitments, net medium-term bank lending continued to contract. The turnaround followed a contraction in bank claims in 2002 associated with the crises in Argentina and Brazil, and concentrated on these countries.

There was no significant rebound in bank lending to Brazil in 2003, despite the marked recovery in creditor sentiment. This reflected weak demand, partly due to the availability of alternative sources of financing. Lending to Argentina, too, was stagnant in 2003, although the pullback in lending associated with the country’s financial crisis seems to have been completed in 2002. International lending to Mexico contracted in 2003, in part reflecting weaker demand for external finance due to the development of local capital markets as an alternative source of finance.

Net repayments to banks in the East Asia and Pacific region moderated in 2003, after substantial net repayments in 2002. While borrowers from Indonesia and the Philippines continued to reduce their liabilities to banks, outflows from Thailand moderated. Lending to borrowers in South Asia, which previously had been contracting, started to increase again in 2003, possibly in response to a perception of improved credit quality, as reflected in the upgrade of India’s credit rating early in 2003.

Bank lending to Eastern Europe and Central Asia increased further in 2003, with lending to the Russian Federation particularly strong. This likely reflected the generally high, and improving, credit quality in the region, as several countries neared accession to the European Union. Moreover, many European banks boosted lending in support of multinational companies active in Eastern Europe and in support of their local operations. The increase in short-term flows was particularly strong. Borrowers in Sub-Saharan Africa continued to make moderate net repayments to commercial banks in 2003, as has been the pattern in recent years.

Overall, banks have recently reduced corporate lending in both developed and developing countries, across all regions. The shift was most pronounced in Latin America. By the third quarter of 2003, bank claims on the nonbank private sector in Latin America accounted for 61 percent of claims on Latin America, down from 69 percent in 2002.

### Table 2.5 Net bank flows to developing countries, 2001–03

<table>
<thead>
<tr>
<th>Region</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>All developing countries</td>
<td>−40.4</td>
<td>−10.0</td>
<td>17.5</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>−11.9</td>
<td>−4.4</td>
<td>3.6</td>
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<tr>
<td>Europe and Central Asia</td>
<td>−1.7</td>
<td>18.5</td>
<td>22.1</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>−17.7</td>
<td>−21.1</td>
<td>−4.0</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>−2.4</td>
<td>−1.3</td>
<td>−4.9</td>
</tr>
<tr>
<td>South Asia</td>
<td>−2.8</td>
<td>3.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>−3.9</td>
<td>−5.0</td>
<td>−1.8</td>
</tr>
</tbody>
</table>

the third quarter of 2002. Over the same period, bank claims on public sector entities increased slightly in the major emerging-market economies.

**Decline in bank margins relatively modest**

Unlike the sharp decline in bond-market premiums, the average pricing margin charged on new syndicated loans in 2003 was virtually unchanged from the previous year at 165 basis points (table 2.6). Margins for bank lending are relatively less affected by short-term developments in the capital markets because such lending is more relationship-based. Average margins edged up, however, for medium-term loans in most regions. Margins remain very tight for the majority of borrowers in Eastern Europe and East Asia, but some borrowers face significantly wider margins. Typical margins for trade-related lending to private borrowers in the Russian Federation were about 300 basis points. The average maturity of new syndicated loans recovered to 49 months in 2003, from 45 months in 2002, but it remained slightly below the level of earlier years. Some 17.9 percent of new syndicated loans had a maturity of one year or less, compared with 15 percent in 2002.

**The changing strategies of international banks**

The moderate recovery in bank lending in 2003 comes against a background of a general retrenchment of banks from cross-border bank lending since 1997. Several factors account for that retrenchment, and their continuing influence is likely to keep international bank lending moderate over the medium term.

International bank lending has been disproportionately affected by the reduction in demand for external borrowing, since many of the emerging-market borrowers, particularly in Asia, that have sought to reduce their leverage previously borrowed predominantly from international banks. The ability of domestic financial institutions in some countries to access international capital markets accounts for some of the reduction in the demand for bank lending. Top-tier Brazilian banks, for example, have used structured bond issues, secured by remittance transfers, to raise funds on international markets and have on-lent the proceeds.

The experience of successive financial crises after the mid-1990s sensitized commercial banks to the risks of lending to developing countries and prompted managements to review their risk strategies. As a result, the risk-management techniques and procedures used by internationally active banks have been greatly strengthened in recent years, with the widespread adoption of value-at-risk models and a greater emphasis on stress-testing. Enhanced scrutiny of risky lending, including to developing countries, typically remains in place.

Banks have reduced the risk profile of their lending by reducing their lending to emerging markets in general—and to riskier countries within these emerging markets in particular. According to figures from the Bank for International Settlements (BIS), the share of reporting banks’ international claims on developing countries as a proportion of their total international claims fell from 12.9 percent in mid-1999 to just 8.6 percent in September 2003. Within each of the major regions there has been a shift in the proportion of lending toward relatively highly rated countries, and away from countries with relatively low credit ratings. According to BIS calculations, the average credit rating of the emerging-market lending portfolio of reporting banks improved from about B in mid-1999 to over B+ in March 2003, holding the credit rating of individual countries constant at 1999 ratings (McGuire 2003).

There has also been a more general strategic change in the operations of many internationally active banks. That change has typically involved a move toward business lines that generate fee income—such as market-making, bond- and equity-underwriting, and asset management—and away from traditional interest-earning activities. In 2002,
for example, only about 30 percent of Deutsche Bank’s revenue derived from interest-earning activities, although a figure of 50–60 percent was more typical for international banks. Some banks are seeking to combine the provision of traditional banking services with other financial services, including insurance, hoping to benefit from the cross-selling of services. In mid-2003, holdings of securities accounted for 25 percent of BIS-reporting banks’ cross-border claims, compared with 11.5 percent in 1995. Similarly, 18.9 percent of bank claims on developing countries consisted of securities’ holdings in 2003, compared with 7.4 percent in 1995 (figure 2.17).

The wide range of strategies followed by internationally minded banks have had an impact on their lending to developing countries. Nearly all large banks seek to provide their domestic customers with international services, and many aim to provide corporate and investment banking services globally to these clients. Some of the largest banks are seeking to establish a global presence, including local retail banking in many countries. Others have sought to supplement their domestic activities with a local presence concentrated in specific regional markets. British-based Standard Chartered is one bank that is targeting its future growth on building on an established presence in emerging markets, rather than on competing in the developed-country markets.

Nevertheless, some banks that formerly were very internationally active have decided to review the countries and business lines in which they are active and to be much more selective about their investment choices and deployment of resources. In markets where a wider distribution network is an immediate priority, such institutions are now emphasizing joint ventures with local partners, rather than acquisitions. Some banks, particularly in Germany, have been trying to reduce the size of their balance sheets by reducing risk-weighted assets.

Banks have also taken advantage of advances in capital markets and improved technology to free up their balance sheets by converting pools of loans they have originated into securities that can be traded in capital markets. According to this practice, a portfolio of assets is transferred from the balance sheet of the originating bank to a special purpose vehicle, which refines itself by issuing securities on the reference portfolio to capital markets at a margin. Cross-border lending to developing countries may have become relatively less attractive for international banks to the extent that it is less amenable to securitization than other forms of lending, for example, because it is less homogenous than credit card or mortgage lending.

### Changing regional patterns of international bank finance

There have been important regional influences on the pattern of bank lending. In particular, cross-border bank lending has been the predominant form of international external finance for East Asia, and regional demand for such financing has fallen significantly since the East Asian crisis.

North American and, most strikingly, Japanese banks have sharply reduced their cross-border lending to developing countries since the Asian crisis of 1997 (table 2.7). By September 2003, lending by Japanese banks to developing countries was just one-third of its level in June 1997. This change, of course, reflects the weakened state of the Japanese banking system, as well as reduced demand from Japanese companies operating in other countries (figure 2.18). Over the same period, cross-border lending by North American banks to developing countries fell by 24 percent (figure 2.19). European banks, which accounted for a little over one-half of bank lending to developing countries in 1997, increased their exposure, particularly between 1997 and 2000. They now account for nearly two-thirds of such lending.
Important structural changes also have occurred in the regional pattern of borrowing. These have both affected and been affected by the willingness of banks in different regions to lend to developing countries. International claims on East Asia and the Pacific, for example, declined from $233 billion in 1997 to $152 billion in 2003 as Asian borrowers sought to “deleveraging” and reduce their exposure to international lending. Japanese bank lending in Asia fell by 72 percent between June 1997 and September 2003; it now accounts for just 17 percent of international claims on the region, compared with 40 percent in 1997.

More recently there have been signs of an incipient revival in bank lending to Asia, including signs that Japanese banks are again willing to participate in international syndicated loans in the region.

International claims on Latin American countries expanded between 1997 and 2000, but since have fallen back, at least partly in response to the crises in Argentina and Brazil. It is noteworthy that much of the expansion and subsequent contraction in lending to Latin America was on the part of European banks, with Spanish banks particularly prominent. American and Japanese banks have reduced their exposure to Latin America since 1997.

Another striking development is the extent to which international bank lending to “emerging countries” expanded between 1997 and 2000, but since have fallen back, at least partly in response to the crises in Argentina and Brazil. It is noteworthy that much of the expansion and subsequent contraction in lending to Latin America was on the part of European banks, with Spanish banks particularly prominent. American and Japanese banks have reduced their exposure to Latin America since 1997.

### Table 2.7 International claims of BIS-reporting banks

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>U.S. and Canada</th>
<th>Japan</th>
<th>Europe</th>
<th>Residual</th>
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<td>All developing countries</td>
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<td></td>
<td></td>
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<tr>
<td>Jun. 1997</td>
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<td>Dec. 2000</td>
<td>749.4</td>
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<td>Sep. 2003</td>
<td>735.1</td>
<td>88.1</td>
<td>44.9</td>
<td>475.0</td>
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<td>East Asia and Pacific</td>
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<td>Jun. 1997</td>
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<td>20.7</td>
<td>92.5</td>
<td>94.2</td>
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<td>Dec. 2000</td>
<td>171.7</td>
<td>12.2</td>
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<td>54.7</td>
<td>8.8</td>
<td>126.8</td>
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<td>1.2</td>
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<td>52.2</td>
<td>3.7</td>
<td>3.7</td>
<td>36.2</td>
<td>8.7</td>
</tr>
</tbody>
</table>

Note: Figures derived from BIS consolidated banking statistics. International claims include both cross-border claims and local claims denominated in foreign currencies. Changes in coverage and the reporting practices of reporting countries have occurred over the period. Figures have been adjusted to the World Bank’s current coverage of developing countries. The comparison of stocks in different periods is affected by changes in the valuation of lending denominated in currencies other than the U.S. dollar.

Source: Bank for International Settlements and World Bank staff calculations.

![Figure 2.18 Foreign lending of Japanese banks to developing countries, 1983–2003](image)

![Figure 2.19 Foreign lending of U.S. banks to developing countries, 1983–2003](image)
Europe” has increased, rising from $119 billion in 1997 to $222 billion in September 2003. This increase is entirely accounted for by European lenders. One important factor behind the increase in intra-European lending is the marked improvement in the creditworthiness of many of the countries in the region, as reflected in credit rating upgrades.

Lending to the Middle East and North Africa, South Asia, and Sub-Saharan Africa and has edged up since 1997, principally as a result of greater lending by European banks. Japanese banks have reduced their lending to South Asia and to the Middle East and North Africa, but increased lending slightly to Sub-Saharan Africa.

Global expansion of banks and growth of local-currency claims
While the cross-border lending of banks to developing countries has stagnated or contracted in recent years, many banks have significantly stepped up their local operations in developing countries, often through the acquisition of local banks (figure 2.20). Increased awareness of the risks of currency mismatches for both borrowers and lenders gave additional impetus to this process. According to BIS figures, local claims in local currency accounted for 39.4 percent of total foreign claims of international banks on developing countries in September 2003, compared with just 14 percent in 1995 (box 2.5). Local lending has largely been matched by an increase in local deposits (figure 2.21).

Alongside a process of domestic consolidation in Spanish banking, which saw the formation of...
two dominant banking groups—Banco Santander Central Hispano and Banco Bilbao Vizcaya Argentaria (BBVA)—the country’s banks have followed a distinctive strategy of looking to Latin America to expand outside their domestic market, primarily through a series of acquisitions. As a result, the local-currency claims of local affiliates of Spanish-headquartered banks increased from just $1.7 billion in 1994 to a peak of $130 billion in the first quarter of 2002 (figure 2.22). However, events in Argentina have caused at least some banks to reexamine their strategy. In January 2003, BBVA sold its Brazilian bank to Bradesco, although it maintains a presence in eight other Latin American countries and recently took full control of BBVA Bancomer (box 2.6). Partly in consequence, local-currency claims have fallen from their peak.

Deregulation and the challenges created by banking crises have played an important role in

Box 2.6 Will experience in Argentina reverse the shift toward local operations?

Seeking to capitalize on their risk management and technological expertise, international banks have significantly expanded their local operations in developing countries, often at the expense of traditional cross-border lending. However, the heavy losses of foreign banks in Argentina, where dollar assets and liabilities were converted into pesos at unfavorably asymmetric rates, and where banks were pressured to hold government bonds, have brought this strategy into question.

To date, however, the effect appears muted. Local-currency claims of local operations of foreign banks continued to expand to $560 billion in June 2003, from $524 billion at the end of 2001 and just $226 billion at the end of 1997.

There have been no large-scale disinvestments from Latin America, although a few banks have sold or scaled back their Latin American operations. Local-currency claims on Latin America have fallen back to $250 billion from their peak of $286 billion at the end of 2001. Local-currency claims of BIS-reporting banks on Brazil fell from $66.1 billion in the third quarter of 2001 to $51.4 billion in mid-2003. Even after adjusting for the effect of changes in the exchange rate, this amounts to a 16 percent contraction in local-currency claims in Brazil, partly reflecting the disinvestment of BBVA. In Argentina itself, local-currency claims fell to $13.4 billion in June 2003, from $20.1 billion in September 2001.
the entry of international banks into the local markets of developing countries. The difficulties of the Mexican financial system in the aftermath of the 1994–95 tequila crisis brought a significant increase in foreign ownership in the Mexican banking system, assisted by a relaxation of restrictions on foreign involvement. Mexico’s largest banks were among those acquired, with mergers between Bancomer and BBVA and between Serfin and Santander. The process culminated in the Citigroup-Banamex merger of 2001. Canadian banks, encouraged by the North American Free Trade Agreement, also made acquisitions of Mexican financial institutions.

In the mid-1990s, the Brazilian authorities used their powers to license foreign operations to help resolve the difficulties that some Brazilian banks encountered as very high rates of inflation—from which they had profited—were brought under control. Foreign banks were also important players in the privatization of banks owned by the states, notably through Banco Santander’s acquisition of Banespa, the state bank of Sao Paulo.

Second-tier banks from some European countries, including Austria, Belgium, Germany, and Italy, have sought to expand in Central and Eastern Europe ahead of the enlargement of the European Union in 2004. This process has been aided by the privatization of state-owned banks in several countries. Some 93.9 percent of local currency claims of local affiliates of BIS-reporting banks in Eastern Europe are now attributable to banks headquartered in Europe. Examples include the German HVB and its affiliate, Bank Austria; KBC from Belgium; and San Paolo-IMI from Italy. A leading Polish bank, Bank Handlowy w Warszawie, with assets of $7.25 billion, was acquired by Citibank in 2001, but otherwise the direct involvement of U.S. banks in Eastern Europe is relatively limited.

Bank lending to Africa has not been exempt from the general trend toward greater direct local involvement, with local currency claims reaching $22 billion in 2003, compared with just $5 billion in 1992 (figure 2.23). Most of that amount is accounted for by banks based in Britain (Standard Chartered), France (BNP Paribas), and the United States (Citibank).

Japanese banks have not built up a significant local presence in developing countries. Local-currency local claims of Japanese banks amounted to just $10 billion in 2003, almost entirely in Asia.

Progress in reforming the international financial architecture

The official community, developing countries, and market participants are continuing their efforts to reduce the severity and frequency of financial crises, particularly those likely to be accompanied by contagion. In 2003, covenants and guidelines intended to improve the sustainability and management of developing-country debt made significant progress.

Collective action clauses

The most notable of developments was the swift transition from debate to implementation of collective action clauses (CACs) under New York law. The use of CACs in bonds governed by U.K. and Japanese law has been a longstanding practice (box 2.7). However, bonds issued under New York law, which account for a large share of developing-country bonds, previously included only majority enforcement provisions (one of the features of CACs) and not majority restructuring provisions, which were adopted by developing countries in 2003. The inclusion of the latter provisions, which were being discussed as an option alongside IMF’s sovereign debt restructuring mechanism, is intended to contribute to orderly and rapid workouts of distressed sovereign debt. These provisions limit the ability of minority bondholders to disrupt or slow down debt restructuring proceedings by enforcing their claims through litigation. They also bind all investors holding debt covered by CACs.
Box 2.7 Collective action clauses

Collective action clauses (CACs) enable a qualified majority of bondholders to make decisions that become binding on all holders of a particular bond issue, thereby encouraging a more orderly and prompt restructuring of distressed bond debt. CACs could also help governments avoid the large macroeconomic costs they might incur if they were unable to restructure unsustainable debts in an orderly and predictable way. There are two important features of CACs:

The majority restructuring provision. This provision enables a qualified super-majority of bondholders to bind all bondholders within the same issue to the financial terms of a restructuring agreement, either before or after a default. Thresholds that have been used for amending payment terms have ranged from 66-2/3 percent to 85 percent of either the outstanding principal or of the claims of bondholders present at a duly convened meeting. Majority restructuring provisions have long been found in bonds governed by English, Japanese, and Luxembourg law, whereas bonds governed by New York law did not include them until very recently.

The majority enforcement provision. This provision is designed to limit the ability of a minority of bondholders to disrupt the restructuring process by enforcing their claims after a default but before a restructuring agreement. Two such provisions can be found in bonds governed by U.K. and New York law: (a) an affirmative vote of a minimum percentage of bondholders (typically representing 25 percent of the outstanding principal) is required to accelerate claims after a default; and (b) a simple or qualified majority can reverse such an acceleration after the default on the originally scheduled payments has been cured. An even more effective type of majority enforcement provision can be found in trust deeds governed by English law, according to which the right to initiate legal proceedings on behalf of all bondholders is conferred upon the trustee subject to certain limitations. However, it is up to issuers and investors to decide whether the use of trust deeds is cost-effective.

In addition, the G-10 Working Group (set up at the recommendation of the G-10 ministers and governors in 2002) made specific recommendations that would help in designing CACs. These were (a) a disenfranchisement provision, which would exclude, for quorum and voting purposes, bonds owned or controlled, directly or indirectly, by the issuer or its public sector instrumentalities; (b) an engagement provision, which would promote dialogue between the sovereign and the bondholders; and (c) transparency provisions, which would require the sovereign to provide certain information to bondholders over the life of the bond, and additional information following an event of default. These recommendations could be incorporated immediately into sovereign bonds governed by English, French, and New York law and in bonds governed by Japanese law with some modifications.

Source: IMF and World Bank, Guidelines for Public Debt Management.
closer to those preferred by creditors represented by the Emerging Market Creditors Association, including an 85 percent super-majority. Other sovereigns, such as Belize and Venezuela, also used the 85 percent threshold.

Direct comparison of the price impact of including CACs in bonds is limited by the availability of adequate pricing benchmarks particular to each sovereign, as well as differences in bond-market conditions over time. However, market participants have indicated that the inclusion of such clauses has had almost no effect on the pricing of bonds. Instead, almost all bond issues reportedly received strong investor interest.

The use of CACs provides a useful tool in the event a sovereign is forced to restructure its debt. However, progress still must be made on issues not covered by CACs, especially in relation to the aggregation of debt. Generally, the use of CACs in a particular bond binds creditors to procedures and covenants related to that issue alone. They do not provide for aggregation of claims by creditors of other bonds and cannot facilitate collective action by a super-majority of investors across different bond issues or types of creditors. Thus, it will take considerable time to bring all outstanding bond debt under the realm of CACs. One provision may partially address the issue of aggregation: if two or more bonds are restructured, a majority of all bondholders may opt in favor of aggregated voting. Undue influence by governments on debt restructuring may be prevented by the disenfranchisement provisions of CACs, which would prevent bonds owned or controlled by government entities to be counted or voted.

Additionally, efforts must continue to bring CACs up to par with the provisions envisaged originally by the G-10 countries and financial industry associations. The majority amendment provision, which allows restructuring with a super-majority of creditors, and the collective enforcement provision, which allows restructuring to be accelerated following a default by a minimum percentage of bondholders, are already operational. However, the engagement provision, which spells out procedures for communication between debtor and creditors, and the information provision, which specifies the information that borrowers must provide throughout the life of the bond and in the event of a default, still require further progression.

### Code of conduct

Efforts to strengthen the international financial architecture also include discussions among developed and developing countries, international financial institutions, and various capital market participants aimed at formulating a code of conduct to be voluntarily followed by private and official creditors, as well as sovereign borrowers, in situations in which debt sustainability is in question, thus enhancing the stability of the international financing environment. First proposed at the G-20 ministerial meeting in October 2002, these efforts were endorsed by the G-7 finance ministers and central bank governors in February 2003. So far discussions have produced a consensus that the code should be voluntary and flexible, and that it should balance the interests of debtors and creditors. A balance remains to be achieved concerning other features of the code, including its scope.

### Standards and codes

Increased recognition and monitoring of standards and codes has been an important part of the institutional response to the shortcomings revealed by the emerging market crises of the late 1990s. Increased scrutiny by the official sector of adherence to standards and codes increases awareness of risks and is also likely encouraging greater adherence to the standards. Private investors and creditors also seem to be increasingly aware of these issues and of how particular countries perform in relation to these codes, using the information to improve risk management.

The IMF and the World Bank have recognized 12 areas and associated standards as useful for the operational work of the Fund and the World Bank, and which they are monitoring compliance
with. These comprise accounting, auditing, anti-
money laundering and countering the financing of
terrorism, banking supervision, corporate govern-
nance, data dissemination, fiscal transparency,
solvency and creditor rights, insurance supervi-
sion, monetary and financial policy transparency,
payments systems, and securities regulation. Re-
ports summarizing countries’ observance of these
standards are used to help sharpen IMF and
World Bank policy discussions with national
authorities, and by the private sector (including
by rating agencies) for risk assessment.

**Basel II**

The proposed new Basel Capital Accord (Basel II)
is likely to exert a strong influence on the behavior
of internationally active banks—and hence on
their lending to developing countries. The revision
is designed to enhance the safety and soundness of
the banking industry worldwide by closely align-
ing regulatory capital with banks’ credit, market,
and operational risks. The new accord replaces
and in many ways improves the original Basel ac-
cord, which had a crude system of weighting assets
according to risk categories. That system has long
been inconsistent with the increasingly sophisti-
cated risk-management practices of major banks.
The Basel Committee on Banking Supervision
(BCBS) plans to finalize the revised accord by mid-
2004 and to implement it by the end of 2006 in
BCBS member countries.

Basel II is based on three “pillars”:

- **Minimum capital requirements**, with a sensi-
tive weighting of the riskiness of different assets
in calculating the denominator of this ratio.
- A strengthened role for **supervisory review**, as
  a result of which a bank may be required to
  hold additional capital.
- Greater **public disclosure** to enable other finan-
cial institutions to exercise stronger “market
discipline.”

Under the first pillar no changes in the minimum
capital ratio are planned. Banks will be able to
adopt one of three options for calculating risk-
weighted assets:

- The “standardized” approach, where the risk
  weights for sovereign, interbank, and corpo-
  rate exposures are differentiated according
to external credit ratings. For sovereign ex-
  posures, credit assessments developed by
  Organisation for Economic Co-operation and
  Development (OECD) export credit agencies
  may also be used.
- Two “internal-ratings-based” (IRB)
  approaches—under which banks are permit-
ted to use their own credit-risk models to de-
termine risk weights, subject to demanding
  validation requirements.

The revised accord incorporates some incentives to
move to the IRB approaches so as to encourage
the use of advanced risk-management techniques.
It also extends the coverage of minimum capital
requirements to cover operational risk—the risk
of losses from inadequate or failed internal pro-
cesses, people, and systems, or from external
events. And it recognizes a wider range of “credit
risk mitigants” such as collateral, guarantees, and
credit derivatives.

In October 2003, members of the BCBS
reached a compromise on issues that had sharply
divided bank regulators in the United States and
Europe and threatened to unravel the proposed re-
vision of the accord after four years of work. The
standardized approach will continue to be cali-
brated to cover “unexpected losses” and “expected
losses.” But for those banks implementing the ad-
vanced approaches, using their own internal risk
models, minimum capital requirements will now
cover only unexpected losses. In the latter case, the
adequacy of provisions for losses will be taken into
account through modifications to the definition of
capital.

Work has begun in a number of countries on
draft rules to integrate Basel capital standards with
national capital regimes. In early 2003, U.S. regu-
lators indicated that they would require only the
largest 10 U.S. banks to comply with the new ac-
cord, with perhaps another 10 large regional banks
also likely to choose to do so. However, these
banks currently together account for some 99 per-
cent of the cross-border lending of U.S. banks.

Although the accord is a clear improvement
over its predecessor, there are some drawbacks.
The new accord is substantially more complex than
its predecessor and will involve significant compli-
ance costs for financial institutions. Some also fear
that implementation of the accord may further dis-
courage bank lending to developing countries. In
particular, a number of critics believe that the proposed accord pays insufficient attention to the benefits of diversification and thus may overstate the risk of lending to developing countries.

The accord may also accelerate the process of disintermediation, encouraging an increasing proportion of lending to originate from financial institutions not subject to the regulatory requirements of the accord. Relatively lightly regulated institutions, such as insurance companies and pension funds, are bearing an increasing proportion of the risk of lending to emerging markets through bond holdings and the sale of credit derivatives.

There is also a risk that implementation of the new accord will amplify the procyclicality of bank lending. That is, lending is likely to be reduced further at times when activity is turning down, since assessments of risk are influenced by the cyclical position. In principle, external credit ratings are intended to apply “through the cycle,” but in practice the evidence suggests that initial ratings and rating changes are sensitive to the state of the business cycle (Amato and Furine 2003). This is also likely to apply to internal models, which typically have a relatively short time horizon.

It is not clear that the accord will fully achieve its central aim of establishing a level playing field for internationally active banks. Differences between the standardized and IRB approaches mean that banks adopting one approach or the other will be advantaged or disadvantaged in certain circumstances (box 2.8). Inconsistent implementation of Pillar II is another area that may lead banks based in different countries to face different regulatory burdens. Under Pillar II, individual country supervisors may require a bank to hold additional capital, beyond that required by the standard ratio, on the basis of supervisory review. The quality and intensity of supervisory review will likely vary from country to country, and banks will be more likely to be subject to additional capital requirements in some countries than in others.

The original accord became a global standard and had been adopted in more than 100 countries.

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Box 2.8 How Basel II affects developing-country risk weights

**Key differences in the risk weightings of the existing international banking accord and Basel II include:**

- For all but the most highly rated OECD debtors, the risk weight of lending to banks and sovereign borrowers will increase.
- For corporate exposures, the risk weighting for highly rated borrowers will be lower, and that for lower-rated borrowers somewhat higher, than at present.
- Under the standardized approach, lending to OECD banks below the highest rating category would generally attract a higher risk weighting than at present.
- Lending to highly rated non-OECD banks will typically attract a lower risk weighting than at present. But those in the very lowest rating category will have a higher weighting. For short-term lending to banks, the weighting will not change for lending to highly rated banks, but it will increase for middle- and lower-rated banks.
- The risk-weighting curve to be used in the basic internal-ratings-based approach implies substantially higher risk weightings for the lowest rating categories than does the standardized approach. As a result, the differences between the two approaches provide a regulatory incentive for sophisticated banks using their own internal models to concentrate on less risky lending and for those banks using the standardized approach to lend to riskier borrowers.
- For project finance loans, banks using the advanced internal-ratings-based approach and having sufficient data to validate may now simply use weightings that apply to corporate borrowing.

A simple comparison of the existing risk weights with those proposed under the accord inevitably overstates the likely change in bank incentives and behavior, however. Most banks already hold an additional cushion of capital beyond the minimum regulatory requirement. As a result, the existing minimum regulatory capital requirements are typically not “binding.” Moreover, banks’ own internal capital budgeting procedures may already reflect their assessment of the risks inherent in lending, rather than simply the regulatory requirements.
by the mid-1990s. The new framework is intended to be suitable not only within the G-10 countries represented on the BCBS, but also as an option that countries around the world might apply to their banking systems. Many developing countries are likely to implement the accord in some form, although not necessarily by the end-2006 date targeted for implementation by BCBS members.

Most analyses suggest that implementing the Basel accord in developing-country banking systems would require substantial increases in regulatory capital. A particular concern for the implementation of the standardized approach in emerging-market countries is that relatively few companies have external credit ratings. As a result, the new accord is likely to result in relatively undifferentiated risk weights for developing-country banks. This is likely to result in incentives for foreign banks (which are able to use the more advanced and risk-sensitive systems) to focus on less risky borrowers, while domestic bank lending concentrates on low borrowers of lower quality, with potential risks for the health of the domestic banking system.

**Equator Principles and the Extractive Industries Transparency Initiative**

In 2003, major international banks, collectively accounting for more than 70 percent of the worldwide project loan market, adopted the Equator Principles, a voluntary set of guidelines to be applied to their project finance activities, based on the environmental and social guidelines and safeguard policies of the International Finance Corporation.

In December 2003 the World Bank Group announced its formal endorsement of the Extractive Industries Transparency Initiative and pledged to work with developing nations and companies on ways to publish revenues accruing from oil, gas, and mining sectors.

**Prospects for private debt flows**

Strong debt flows are likely to continue into 2004, driven by buoyant liquidity conditions and the global economic recovery. There were substantial inflows from retail, high-net-worth, and European institutional investors in late 2003. The demand for external finance will likely be influenced positively by the stronger growth—particularly in investment—foreseen for the developing countries. Adjustments to earlier changes in the desired stock of borrowing and lending—for example, in Asia—seem to have largely run their course and will no longer depress demand significantly. Moreover, a number of countries that have had limited market access so far—in some cases because they are recovering from financial crises—are gradually recovering market access.

The possibility that the large and rapid decline in spreads on emerging-market debt has run ahead of the underlying improvement in credit quality nevertheless raises the prospect of some correction in spreads. Investors are therefore unlikely to be able to match the very strong returns that they achieved over the past year—and they may even struggle to achieve positive returns on emerging-market debt this year. The handling of the restructuring of Argentina’s defaulted debt also could influence the attitude of investors to emerging market debt.

Several developing countries face elections in the near future. It will be important for governments in developing countries to maintain prudent macroeconomic policies and persevere with needed reforms to foster sustainable growth, to consolidate the improvement in credit quality, and to maintain the confidence of investors and creditors, particularly in the face of political pressures.

Higher interest rates in the advanced economies may dampen flows as they provide more attractive alternatives for investors and raise borrowing costs for developing countries. And if the resolution of imbalances in the advanced economies eventually requires abrupt adjustments in the international financial markets, lending to developing countries may be adversely affected. The concentration of lending among a relatively small number of banks and major institutional investors raises the risk that strategic changes by a single institution could have a noticeable impact on overall flows.

**Notes**

1. This may reflect the influence of market discipline, with higher capital required for access to critical markets, such as the swaps market.

2. ABN Amro, Barclays, CIBC, Citigroup, Credit Suisse Group, Credit Lyonnais, Dexia, Dresdner Bank, HSBC, HVB Group, ING, Mediocrédito Centrale, Mizuho Corporate Bank, Rabobank, Royal Bank of Canada, Royal Bank of Scotland, WestLB, and Westpac.
References


Annex: Commercial Debt Restructuring

This annex provides a tabulation of commercial debt restructuring activities of developing countries since the 1980s. It does not include restructuring undertaken voluntarily for the purpose of liability management by sovereigns, such as exchanging previously existing debt with issuance of new fixed income securities for cost effectiveness, among other benefits. However, it does include debt buybacks by countries, undertaken to preempt formal restructuring of debt or reduce debt hangovers, and which were also aided by official financing.

In 2003, there was one debt-restructuring operation undertaken through a debt swap, and two countries remained in process to restructure their previously defaulted debt. In May, Uruguay completed its debt exchange operation, swapping about $5.4 billion of debt. The eligible debt included $3.8 billion of external debt, $1.6 billion in domestic debt, and $256 million of Samurai bonds (denominated in yen). This operation aimed at extending maturity without any reduction in principal or interest. All investors were offered extensions on maturity, as well as the opportunity to swap into new benchmark bonds. Following the largest sovereign default in history, Argentina formally proposed its debt-restructuring plan in 2003. The government’s proposal envisages three new bonds, with maturities ranging from 8 years to 42 years, and carrying interest rates as low as 0.5 percent to 5 percent. In addition, it is offering to pay no interest arrears that have been accumulated since the default. However, as of February 2004, formal negotiations with creditors had not commenced. Serbia and Montenegro was in negotiations to restructure about $2.7 billion of its debt owed to the London Club of commercial creditors. The country was at an advanced stage of the restructuring procedure as of February 2004.

The International Development Association (IDA) created a Debt Reduction Facility in 1989 to help low-income countries manage their commercial debt burdens. Since its inception, the facility completed 22 operations for 21 countries. In 2003, there was only one IDA-sponsored debt buyback operation, and four in progress. In August 2003, Cameroon completed a debt buyback operation to retire $266 million of principal, equivalent to 79 percent of eligible principal debt, and about $530 million in interest arrears. The buyback price for the operation was set at 14.5 cents per dollar of principal. The operation was funded by the IDA Debt Reduction Facility and the governments of France, Norway, and Cameroon. Tanzania’s second buyback operation, scheduled for April 2004, would extinguish about $20 million of principal and $18 million of associated interest. In addition, three operations for Mozambique, Madagascar, and Nicaragua are being prepared. These operations would extinguish about $680 million in eligible debt (including interest arrears).
Notes on how to use these tables
The dates shown are those of agreements, not when the original payments due were missed. Deferment refers to short-term rollover of current maturities. Rescheduling refers to consolidation of debt into new long-term obligations; may include arrears as well as future maturities; interest and short-term debt included only if indicated in country notes. New money refers to loans arranged for budgetary or balance of payments support in conjunction with debt rescheduling, usually in proportion to each creditor bank’s exposure; sometimes referred to as concerted lending. Short-term credit maintenance refers to understanding by banks to maintain the size of existing trade or other short-term credit facilities, arranged in conjunction with debt rescheduling. The figures for Brady deals include face value of buybacks and of all debt exchanges. The Brady deals were also known as officially supported debt and debt service reduction agreements.

Albania
Bank debt restructurings
July 1995 Restructuring of $501 million due to commercial banks. Of the total, $371 million bought back for $96.5 million funded by grants from International Development Association (IDA) Debt Reduction Facility (DRF) and other donor countries, and $130 million was converted into long-term bonds.

Algeria
Bank debt restructurings
Feb. 1992 1991–93 Financing Facility, designed to refinance liabilities due between October 1991 and March 1993. Tranche A covered debts with a maturity of two years or more and was repayable in eight years including three years’ grace bearing interest at London interbank offered rate (LIBOR). Tranche B covered debts with a maturity of more than 360 days and less than two years, and was repayable in five years including three years’ grace.


Argentina
Bank debt restructurings
Jan. 1983 Bridge loan ($1.3 billion).
Aug. 1983 New money loan ($0.5 billion).
Aug. 1985 Rescheduling agreement of maturities in January 1982–January 1986 ($9.8 billion); new long-term money ($3.6 billion); maintenance of short-term credit lines ($3.1 billion).
Aug. 1987 Revised restructuring agreement covering amounts under 1983 and 1985 agreements and loans falling due subsequent to those arrangements ($24.3 billion); new long-term money ($1.3 billion); maintenance of short-term credit lines ($3.5 billion).

Brady deal
April 1993 Outstanding stock of $19.3 billion exchanged for either (i) 30-year bonds yielding a market interest rate (LIBOR + 13/16 percent) at a 35 percent discount, or (ii) 30-year par front-loaded interest reduction bonds—FLIRBs (first-year interest rate 4 percent, rising to 6 percent in year seven and remaining there until maturity). Both bonds were collateralized for principal and contained rolling 12-month interest guarantees. Agreement also included $9.3 billion of past-due interest; $0.7 billion was paid in cash at closing; $400 million was written off; the remainder was exchanged for bonds (17-year maturity), repayable in rising installments and yielding LIBOR + 13/16 percent.

Bond market defaults and restructurings
Jan. 2002 Announcement of a moratorium on public foreign debt in December 2001. In January 2002, formalization of default on $85 billion of foreign currency bonds and default on $2.2 billion of local currency bonds. The local currency bonds were exchanged for new debt, which carried covenants less favorable than the original debt. Bonds maturing before 2010 were extended by three years, and the coupon was reduced to 7 percent or less. As of January 2003, the foreign currency bonds were still to be restructured. Stand-by credit facility ($2.98 billion) by the IMF for transitional financial support until August 2003.

Bolivia
Bank debt restructurings
July 1988 Commercial bank debt retired through a buyback ($272 million) and a local currency bond exchange ($72 million). This was a rolling program and applied only to previously deferred loans.
May 1993 Buyback of $170 million commercial bank debt, funded by grants from IDA DRF and other donor countries.

Brady deal
July 1992 (i) Cash buyback at 84 percent discount; (ii) Collateralized interest-free 30-year bullet-maturity par bonds; (iii) short-term discount bonds (84 percent) convertible on maturity into local currency assets at a 1:1.5 ratio, exchangeable into investments for special projects. Past-due interest canceled under all options. Value recovery clause was based on price of tin.
Bosnia and Herzegovina

Bank debt restructurings

Dec. 1997 London Club Agreement to restructure $1.3 billion of principal and past-due interest owed to commercial banks. Past-due interest of $700 million was written off. Eligible principal of $600 million was exchanged for $400 million of uncollateralized discount bonds, 37.5 percent of the new bonds carried a 20-year maturity, including seven years’ grace and stepped-up interest rates rising from 2.0 percent in years 1–4 to LIBOR + 13/16 in years 11–20. Servicing on 62.5 percent of the new bonds was linked to economic performance. The country was not required to make principal or interest payments for the first 10 years. After that the country was required to make debt service payments if per capita income exceeded $2,800 for two consecutive years. Per capita income in 1997 was estimated at $1,079.

Brazil

Bank debt restructurings

Feb. 1983 Rescheduling agreement of $4.8 billion of maturities in January 1983–January 1984; new long-term money ($4.2 billion); maintenance of short-term credit lines ($15.7 billion).

Jan. 1984 Rescheduling agreement of $5.9 billion of maturities in January 1984–January 1985; new long-term money ($6.5 billion); maintenance of short-term credit lines ($15.1 billion).


Nov. 1988 Rescheduling agreement of $61.5 billion of maturities in January 1987–January 1994; new long-term money ($5.2 billion); maintenance of short-term credit lines ($14.8 billion). Also included a broad package of creditor options.

July 1992 Clearance of interest arrears as of December 31, 1990. Cash payment during 1992: $863 million. When term sheet concluded for long-term debt, the balance was to be converted into 10-year bonds (three years’ grace), bearing market interest rates.

Brady deal

April 1994 Four components of debt were restructured totaling $48 billion: (i) debt to foreign banks under the 1988 multyear deposit facility agreement—MDFA ($32.5); (ii) debt to Brazilian banks under the MDFA; (iii) debt resulting from the 1988 new money facilities ($8.1 billion); and (iv) interest arrears accruing from 1991–94 ($6.0 billion). The first category of debt was restructured following a six-choice menu: (i) discount bonds, 30 percent discount, 30-year bullet maturity yielding LIBOR + 13/16 percent with principal collateral and a 12-month rolling interest guarantee ($11.2 billion); (ii) par bonds with a reduced fixed-rate interest (yielding 4 percent in the first year and gradually rising to 6 percent in year seven), 30-year bullet maturity, also with principal collateral and a 12-month rolling interest guarantee ($10.5 billion); (iii) FLIRBs ($1.7 billion), with interest rising from a fixed rate of 4 percent in year one to 6 percent in years five and six and then reverting to LIBOR + 13/16 percent from year seven to maturity, 15 years’ maturity including 9 years’ grace, 12-month rolling interest guarantee; (iv) C-bonds, par-reduced interest rate bonds with capitalization of interest ($7.1), with repayment terms of 20 years’ maturity including 10 years’ grace, interest beginning at 4 percent and the applicable rates in the first 6 years being capitalized, no collateral; (v) conversion bonds ($1.9 billion) combined with new money bonds in a 1:5.5 ratio, interest (yielding 4 percent in the first year and gradually rising to 6 percent in year seven), 30-year bullet maturity, also with principal collateral and a 12-month rolling interest guarantee ($10.5 billion); (vi) par bonds with a reduced fixed-rate interest rate bonds with capitalization of interest ($7.1), with repayment terms of 20 years’ maturity including 10 years’ grace, interest beginning at 4 percent and the applicable rates in the first 6 years being capitalized, no collateral; (vii) conversion bonds ($1.9 billion) combined with new money bonds in a 1:5.5 ratio, interest (yielding 4 percent in the first year and gradually rising to 6 percent in year seven), 30-year bullet maturity, also with principal collateral and a 12-month rolling interest guarantee ($10.5 billion); (viii) interest arrears accruing from 1991–94 ($6.0 billion). The first category of debt was restructured

Bulgaria

Brady deal

July 1994 Creditors agreed to restructure $8.3 billion in public external debt, including about $2.1 billion in PDI. The menu for the original debt included: (i) buyback at 0.25 cent per U.S. dollar ($0.8 billion); (ii) discount bond, 30 percent discount on face value (30 years’ bullet maturity, market rate, $1.7 billion); the discount bonds were collateralized for principal; (iii) FLIRBs. 18 years’ maturity, 8 years’ grace interest beginning at 2 percent, rising to 3 percent in the seventh year and thereafter LIBOR + 13/16 ($1.7 billion). The FLIRBs have one year’s interest rolling interest guarantee. Interest arrears were cleared with a cash payment of about 3 percent, a buyback ($0.2 billion), a write-off of $0.2 billion, and the issuance of PDI par bonds ($1.6 billion) with a 17-year maturity, including 7 years’ grace and a yield of LIBOR + 13/16 percent.

Cameroon

Bank debt restructurings

Aug. 2003 Buyback of $796 million (including interest arrears) of commercial bank debt under the IDA DRF at 14.5 cents per U.S. dollar, financed by IDA DRF and other donor countries.

Chile

Bank debt restructurings

July 1983 Rescheduling agreement of $2.1 billion of maturities in January 1983–January 1985; new long-term money ($1.3 billion); maintenance of short-term credit lines ($1.7 billion).


June 1984 Provision of new long-term money ($0.8 billion).


Nov. 1985 Rescheduling agreement of $3.9 billion of maturities in January 1985–January 1988; new long-term money ($1 billion); maintenance of short-term credit lines ($1.7 billion).


Aug. 1988 Interest spread reduced to 13/16 percent. Also cash buybacks ($439 million).

Dec. 1990 Rescheduling agreement of $4.2 billion of maturities in January 1991–January 1995, including previously rescheduled debt; new long-term money ($0.3 billion). New money bonds not tied to existing banks’ exposure.
Congo, Republic of
Bank debt restructurings
Oct. 1986 Agreement in principle, but never concluded, to restructure 1986–88 maturities, repayable in nine years including three years’ grace, bearing interest at LIBOR + 2.7/8 percent. Approximately $200 million of debt would have been restructured. In addition there was a new money provision of $60 million.

Costa Rica
Bank debt restructurings
Sept. 1983 Rescheduling agreement of $0.7 billion of maturities (including principal arrears) in January 1983–January 1985; new long-term money ($0.2 billion); maintenance of short-term credit lines ($0.2 billion).
May 1985 Rescheduling agreement of $0.5 billion of maturities, including deferment of revolving credit ($2 million) due in January 1985–January 1987; new long-term money ($75 million).
Brady deal
May 1990 Cash buyback at 84 percent discount ($992 million), debt-for-bond-exchange ($579 million), and write-off of $29 million of past-due interest.

Côte d’Ivoire
Bank debt restructurings
Mar. 1985 Rescheduling agreement of $0.5 billion of maturities in December 1983–January 1985; new long-term money ($0.1 billion).
Nov. 1986 Multiyear rescheduling agreement (MYRA) of $0.9 billion of maturities in January 1986–January 1990.
April 1988 Agreement designed to replace the MYRA. Included new money to refinance interest. Interest on the new money portion was LIBOR + 1-1/2 percent. Agreement was not put into effect because interest arrears were not cleared, and current interest payments were suspended in April 1988.

Dominican Republic
Bank debt restructurings
Dec. 1983 Rescheduling agreement of $0.5 billion of maturities in December 1982–December 1983; new long-term money ($0.5 billion).
Dec. 1984 Rescheduling agreement of $0.1 billion of maturities in January 1984–December 1985; maintenance of short-term credit lines ($0.5 billion).
July 1985 Rescheduling agreement of $0.1 billion of maturities in January 1985–December 1986; maintenance of short-term credit lines ($0.5 billion).

Ecuador
Bank debt restructurings
Oct. 1983 Rescheduling agreement of $2.8 billion of maturities in November 1982–December 1983; new long-term money ($0.4 billion); maintenance of short-term credit lines ($0.7 billion).
Dec. 1985 MYRA of $4.2 billion of maturities in January 1985–January 2000. New long-term money ($0.2 billion); maintenance of short-term credit lines ($0.7 billion).
Nov. 1987 Replaces the MYRA.
Brady deal
Feb. 1995 Agreement restructuring $7.8 billion of principal and past-due interest. For principal, creditors agreed to exchange $2.6 billion for discount bonds (45 percent discount) yielding LIBOR + 13/16 percent and $1.9 billion for par reduced-interest-rate bonds. Both bonds had a 30-year bullet maturity and were collateralized for principal and had a 12-month rolling interest guarantee. The interest rate on the par bonds was 3 percent for the first year, rising to 5 percent in year 11. For past-due interest, $75 billion was to be settled in cash at closing; $2.3 billion was exchanged for bonds with a 20-year maturity (no grace period) repayable on a graduated amortization schedule, and $3.3 billion was written off.
Bond market defaults and restructurings
Aug. 2000 Agreement to exchange about $5.9 billion in defaulted Brady bonds and eurobonds for $3.9 billion in new 12- and 30-year global bonds. The new 12-year issue was priced to yield 12 percent, and the new 30-year issue carried the multi-coupon with the initial coupon rate of 4 percent. This operation resulted in a 40 percent reduction in principal for the bondholders.

Ethiopia
Bank debt restructurings
Jan. 1996 Debt buyback at 8 cents per U.S. dollar of $226 million owed to commercial banks. Funding for the operation provided by the IDA DRF.

Gabon
Bank debt restructurings
May 1994 Rescheduling of $187 million of maturities. Principal due through 1994 on debt contracted prior to September 20, 1986 (debt covered by the 1991 agreement, which had not been implemented) was rescheduled. Terms: 10-year maturity including 2-1/2 years’ grace. Interest: LIBOR + 7/8 percent. Arrears of interest and arrears of post cut-off maturities as of July 1, 1994, were to be repaid between 1994 and 1996.
April 2002 Default on $30 million of bank loans, which had been restructured in 1994.

Gambia, The
Bank debt restructurings

Guinea
Bank debt restructurings
Dec. 1998 Buyback of $130 million under the IDA DRF at 13 cents per U.S. dollar, financed by IDA DRF and other donor countries.

Guyana
Bank debt restructurings
July 1988 Deferment of $8 million.
Nov. 1992 Buyback of $69 million under the IDA DRF at 14 cents per U.S. dollar.
Dec. 1999 Buyback of $55.9 million under the IDA DRF at 9 cents per U.S. dollar, financed by IDA DRF and the Switzerland government.

Honduras
Bank debt restructurings
June 1987 Rescheduling agreement of $248 million of maturities due April 1987–December 1989. As two previous agreements (in 1983 and 1984) were not implemented, this agreement incorporated 1981–85 maturities as well, although it too was not signed.
Aug. 1989 Bilateral rescheduling of $101 million, including interest arrears, due to two commercial banks.
Aug. 2001 Buyback of $13 million under the IDA DRF. The buyback price was set at 18 cents per dollar of the principal amount. The IDA and the governments of the Netherlands, Norway, and Switzerland provided funding for the operation.

Indonesia
Bank debt restructurings
June 1998 Agreement on a framework for restructuring $80 billion of the Indonesian private debt. The interbank loans were extended into new government-guaranteed loans with maturities of one to four years, at interest rates of 2.75, 3, 3.25, and 3.5 percent over LIBOR. The corporate debts were to be rescheduled over eight years, including a three-year grace period for repayment of principal. Over the eight-year rescheduling period, the real interest rate was set to be 5.5 percent, but it would decline to 5 percent for debtors who agree to repay in five years. There was also an agreement to pay off trade financing arrears to maintain trade financing from foreign creditor banks.
Sept. 2002 Completion of restructuring of $1.5 billion in syndicated bank credits, as required under the agreement with Paris Club.

Iran, Islamic Republic of
Bank debt restructurings
Mar. 1993 Rescheduling of $2.8 billion of debt outstanding as of March 1993.

Jamaica
Bank debt restructurings


Jordan

Bank debt restructurings


Brady deal

Dec. 1993 Agreement restructuring $736 million of principal and $153 million of past-due interest. For restructured principal, a small amount was repurchased at 39 cents per U.S. dollar, $243 million was exchanged for discount bonds (35 percent discount) and $493 million was exchanged for non-collateralized bonds with a 12-year maturity including 3 years’ grace and yielding LIBOR + 13/16 percent, and $33 million was written off. Up-front costs totaled $147 million, all of which was provided from Jordan’s own resources.

Liberia

Bank debt restructurings


June 1983 Consolidation of $26 million of oil facility debt.

Mauritania

Bank debt restructurings

Aug. 1996 Debt buyback of $33.0 million, at a 90 percent discount, owed to commercial banks. Funding for the operation provided by the IDA DRE.

Madagascar

Bank debt restructurings

Nov. 1981 Arrears ($155 million) on overdrafts consolidated into long-term debt.

Oct. 1984 Restructuring of entire stock of debt ($379 million), including arrears.

June 1987 Modification of the terms of the October 1984 restructuring agreement.


Jan. 2002 Default on $200 million in local currency debt, in addition to continuing default on foreign currency commercial bank loans.

Malawi

Bank debt restructurings


Mexico

Bank debt restructurings


April 1984 New long-term money ($3.8 billion).


Oct. 1985 Deferral of first payment ($0.9 billion) under the March 1985 agreement.

Mar. 1987 Modification of terms of earlier agreements covering $44.2 billion of maturities; new long-term money ($7.4 billion).


Brady deal

Mar. 1990 Agreement restructuring $48.2 billion of debt. In addition to new money of $1 billion, the agreement provided for the exchange of $20.5 billion of debt for bonds at a 35 percent discount, an exchange of $22.4 billion of debt at par for reduced interest rate bonds, and conversion bonds totaling $5.3 billion. The latter were not collateralized and had a tenor of 15 years’ maturity, including 7 years’ grace, and an interest rate of LIBOR + 13/16. The total base also included $693 million not committed to any option.

Moldova

Bond market defaults and restructurings

June 2002 Second default on $75 million foreign currency bond (privately placed) originally issued in 1997. Outstanding amount of the bond reduced to $40 million after the initial default. This time around the maturity of the bond, due in June 2002, was extended until 2009.

Morocco

Bank debt restructurings


Brady deal

June 1990 Rescheduling of $3.2 billion of maturities outstanding as of December 1989. Phase one of this agreement restructured debt; phase two was a Brady deal that would take effect if Morocco had signed an EFF (extended fund facility) agreement with the IMF by December 31, 1991.

Mozambique

Bank debt restructurings

May 1987 Rescheduling of outstanding stock of debt ($253 million), including interest arrears.

Dec. 1991 Buyback of $124 million of outstanding commercial bank debt at a 90 percent discount, funded by grants from the IDA DRF and from France, the Netherlands, Switzerland, and Sweden.

Nicaragua

Bank debt restructurings

Dec. 1980 Rescheduling of government debt ($582 million), all maturities, including arrears.

Dec. 1981 Rescheduling of nationalized bank debt ($192 million), all maturities, including arrears.

Mar. 1982 Rescheduling of debts of non-financial enterprises ($100 million), all maturities, including arrears.


Dec. 1995 Buyback of $1.1 billion of outstanding commercial bank debt at 8 cents per U.S. dollar.

Niger

Bank debt restructurings


Mar. 1991 Buyback of all commercial bank debt at 82 percent discount ($107 million). Resources provided by grants from the DRF for IDA-only countries ($10 million), Switzerland ($3 million), and France ($10 million).

Nigeria

Bank debt restructurings


Mar. 1989 Rescheduling of $5.7 billion of short-term debt, including arrears on line of credit.

Brady deal

Jan. 1992 Agreement rescheduling $5.3 billion of debt. The terms provided for a cash-back at 60 percent discount on $3.3 billion, and debt exchanges on $2 billion for collateralized 30-year bullet maturity par bonds with reduced interest rates: 5.5 percent for the first three years, 6.25 percent thereafter. Creditor selections: 62 percent for the buyback; 38 percent for the debt-reduction bond. A third option, new money combined with conversion bonds, was not selected by participating creditor banks.

Panama

Bank debt restructurings

Sept. 1983 Provision of new long-term money ($278 million); short-term credit ($217 million).


Brady deal

May 1996 Creditors agreed to restructuring of $3.9 billion in public external debt, including $2.0 billion in past-due interest. The menu for the principal included: (i) discount bonds at a 45 percent discount of face value (30 years' bullet maturity, market rate, $87.8 million); (ii) par bonds with reduced interest rates and a 30-year bullet repayment ($268.0 million); and (iii) FLIRBs for $1,612.2 million with a tenor of 18 years' maturity including 5 years' grace period. The discount and the par bonds are collateralized with respect to the principal by U.S. Treasury zero-coupon bonds, and with respect to interest in the form of a 9-month rolling interest rate guarantee in the first year rising to 12 months in two to three years. The FLIRBs do not require guarantee for the capital, but include a six-month rolling interest rate guarantee. PDI settlement included progress payments of $30 million, a payment at closing of $100 million, and the par bonds were collateralized with respect to the principal by U.S. Treasury zero-coupon bonds, and with respect to interest in the form of a six-month rolling interest rate guarantee secured by cash or permitted investments. The FLIRBs did not require guarantee for the capital, but included a six-month rolling interest rate guarantee. PDI settlement included progress payments...
July 1993 Rescheduling of the stock of FSU debt contracted prior to January 1, 1991 ($24 billion), to be repaid with 15-year maturity including 5 years’ grace. In the fourth quarter of 1993, $300 million was to be paid on interest accruing during 1993. At the end of 1993, all remaining unpaid interest (estimated at $3 billion) was to be consolidated and repaid at a 10-year maturity, including 5 years’ grace. The 1993 interest payments were not made; the agreement was not implemented, mainly because

Philippines

Bank debt restructurings
- Jan. 1986 Rescheduling of $5.9 billion in maturities in October 1983–December 1986; new long-term money ($925 million); maintenance of short-term credit lines ($2,974 million).

Brady deal
- Jan. 1990 Agreement provided for $1.3 billion of buybacks at a 50 percent discount.
- Dec. 1992 Following implementation of a cash buyback of $1.3 billion on May 14, 1992, banks selected debt exchanges from three options: (i) front-loaded interest-reduction par bonds yielding LIBOR + 13/16 percent from year seven to maturity (15 years for series A and 15-1/2 year for series B, both including 7 years’ grace); (ii) collateralized step-down/step-up interest reduction bonds yielding 6.5 percent from year six to maturity (25-year bullet maturity for series A and 25-1/2 year for series B); and (iii) new money combined with conversion bonds in a 1:8 ratio, with both bonds attaining 17-1/2 (series A) or 17-year (series B) maturity, including 5 years’ grace and yielding LIBOR + 13/16 percent. Interest payments on both interest-reduction bonds covered by a rolling 14-month guarantee. Creditor choices (total, $4.4 billion, 96 percent total eligible debt): buybacks, $1.3 billion (27.5 percent); option (a), $0.8 billion (46.3 percent); option (b), $1.9 billion (41.1 percent); option (c), $0.5 billion, (11.7 percent).

Poland

Bank debt restructurings
- July 1988 Multyear rescheduling agreement of $8.3 billion of maturities due in January 1988–December 1993; maintenance of short-term credit lines ($1 billion). Also improved the terms of earlier agreements.
- June 1989 Agreement in principal to defer principal due May 1989–December 1990 ($206 million) until December 1991; and in October, the interest due in the fourth quarter of 1989, $145 million, was deferred until the second quarter of 1990.

Brady deal
- Oct. 1994 Creditors restructured $14.4 billion. Three categories of debt were affected: (i) long-term debt covered by the 1988 restructuring agreement ($8.9 billion); (ii) debt due under the Revolving Short-Term Arrangement—RSTA—($1.2 billion); (iii) past-due interest not otherwise restructured ($4.3 billion). The first category was subject to a menu approach: $2.1 billion of long-term debt was repurchased at 41 cents per U.S. dollar, and $0.3 billion of RSTA debt was repurchased at 38 cents per U.S. dollar. For the remaining long-term, creditors chose between (i) discount bonds—45 percent discount ($5.4 billion); (ii) par reduced fixed interest bonds ($0.9 billion); (iii) conversion bonds combined with new money bonds equal to 35 percent of the amount converted ($0.4 billion). The discount bonds and par bonds had 30-year bullet maturities and featured collateralization of principal only. Interest on the discount bonds was LIBOR + 13/16 percent. Interest on the par bonds was 2.75 percent for the first year, rising to 3 percent for year 21. The conversion bonds had a 25-year maturity, including 20-year grace. Their yield in year one was 4.5 percent, rising to 7.5 percent in year 11. The new money bonds had a 15-year maturity, including 10-year grace and yield LIBOR + 13/16 percent. The new money and conversion bonds are not collateralized. The RSTA debt not repurchased ($0.9 billion) was exchanged for 30-year bullet maturity fixed interest bonds, with similar (but slightly different) step-down/step-up arrangements as the par bonds, starting at 2.75 percent in year one and gradually rising to 5 percent in year 21. For past-due interest, $0.8 billion was repurchased with related long-term and RSTA principal. A portion was to be settled with cash payments at closing ($63 million). A portion was written off ($0.8 billion), and the remainder ($2.7 billion), was converted into fixed-interest rate bonds yielding 3.25 percent in year one, rising to 7 percent in year nine. Maturity was 20 years, including 7 years’ grace. Amortization was graduated.

Romania

Bank debt restructurings

Russian Federation

Bank debt restructurings
- July 1993 Rescheduling of the stock of FSU debt contracted prior to January 1, 1991 ($24 billion), to be repaid with 15-year maturity including 5 years’ grace. In the fourth quarter of 1993, $300 million was to be paid on interest accruing during 1993. At the end of 1993, all remaining unpaid interest (estimated at $3 billion) was then to be consolidated and repaid at a 10-year maturity, including 5 years’ grace. The 1993 interest payments were not made; the agreement was not implemented, mainly because
Russia refused to accept bankers’ requirement that sovereign immunity be waived. However, an understanding was reached on October 5, 1994, that the banks would drop their insistence on a waiver of sovereign immunity and that the Vneshekonombank (or another public entity) would guarantee the debts.

Nov. 1995 Agreement in principle to comprehensively reschedule $33 billion in debt outstanding as of November 15, 1995. Heads of terms were signed for rescheduling debt of the former USSR in the amount of $25.5 billion of principal outstanding and $7.5 billion in accrued interest due. The eligible principal was to be repaid over 25 years, with 7 years of grace, beginning December 15, 1995, in 37 semi-annual payments on a graduated schedule at LIBOR + 13/16 percent per year. It was further agreed that an interest note for $6 billion would be issued with a 20-year maturity and 7 years’ grace from December 15, 1995, that would be the same interest rate, listed on the Luxembourg Stock Exchange. The remaining $1.5 billion in interest arrears was paid over 1995–96. By September 1996, the minimum subscribership by commercial banks of $20 billion in outstanding principal was reached which triggered the Russian agreement to the rescheduling package.

Nov. 1998 Outline of an agreement to restructure $13.5 billion of defaulted Treasury bills (GKOs and OFZs). Under the restructuring plan, 10 percent of the defaulted bills was to be redeemed in cash rubles, and 20 percent of the debt was to be exchanged for three-year zero-coupon bonds. The remaining 70 percent of the debt was to be restructured into four-year and five-year variable coupon bonds.

Feb. 2000 Agreement to restructure $31.8 billion Soviet-era debts owe to the London Club of commercial banks. The London Club’s creditors agreed to write off $11.6 billion of the principal and a 7-year grace period for principal repayments, and swapping the rest of its defaulted debts (PRINs [principal notes] and IANs [interest arrears notes]) for a new 30-year eurobonds. The interest rate on a new eurobond was set at 2.25 percent for the first six months, 2.5 percent for the second six months, and 5 percent for years two and seven—yielding 7.5 percent a year.

São Tomé and Príncipe

Bank debt restructurings

Aug. 1994 Buyback under the IDA DRF at 10 cents per U.S. dollar. $10.1 million of principal was extinguished (87 percent of eligible debt).

Senegal

Bank debt restructurings


Dec. 1996 Debt buyback at 8 cents per U.S. dollar of $80.0 million owed to commercial banks. Funding for the operation provided by the IDA DRF.

Sierra Leone

Bank debt restructurings


Aug. 1995 Buyback, at 13 cents on average per U.S. dollar, of $235 million due to commercial banks funded by grants from IDA DRF and other donor countries.

South Africa

Bank debt restructurings


Sept. 1993 Rescheduling of $5 billion, including interest arrears.

Sudan

Bank debt restructurings


April 1983 Rescheduling of $702 million of interest arrears and modification of 1981 agreement.

Mar. 1990 Rescheduling of $1,037 million (including interest arrears).

Suriname

Bank debt restructurings


Tanzania

Bank debt restructurings

April 2001 Buyback of $76.6 million of eligible principal debt and about $79.2 million of associated interest under the IDA DRF. The buyback price was set at 12 cents per dollar of the principal amount with a 5 percent of foreign exchange risk margin. The IDA and the governments of Germany and Switzerland provided funding for the operation.
**Togo**

**Bank debt restructurings**

- Oct. 1983 Rescheduling of $84 million of debts owed to all commercial bank debt, including previously rescheduled debt.
- Dec. 1997 Debt buyback at 12.5 cents per dollar of $46.1 million owed to commercial banks. Funding for the operation was provided by the IDA DRF.

**Trinidad and Tobago**

**Bank debt restructurings**


**Turkey**

**Bank debt restructurings**

- Mar. 1982 Improvement on the terms of the August 1979 agreement, affecting $2.3 billion of debt.

**Uganda**

**Bank debt restructurings**

- Feb. 1993 Buyback of $153 million commercial bank debt funded by grants from the IDA DRF and other donor countries.

**Ukraine**

**Bond market defaults and restructurings**

- July 1999 Agreement to restructure a 10-month $163 million eurobond (including principal and interest). Instead of making the $163 million repayment due in June 1999, Ukraine was to repay 20 percent of bond in cash and swap the remaining 80 percent into a D-mark-denominated eurobond with a maturity of 3 years and coupon yield of 16 percent.
- Feb. 2000 Agreement to restructure $2.7 billion of the short-term debt obligations. No debt forgiveness or reduction in principal was required from bondholders, and all accrued interest on existing eligible bonds was to be paid in full and in cash; all accepting investors were to be offered a new seven-year eurobond, denominated in either euros or U.S. dollars, at an interest rate of 10 percent for euro-denominated bonds and 11 percent for dollar-denominated bonds.
- Mar. 2001 About $21.3 million of the external debt was exchanged for a six-year eurobond, denominated in either euros at an interest rate of 10 percent or U.S. dollars at an interest rate of 11 percent. Bonds eligible for the exchange were deutsche mark 16 percent eurobond due in February 2001, euro 10 percent amortizing bonds due in March 2007, and U.S. dollar 11 percent amortizing bonds due in March 2007.

**Uruguay**

**Bank debt restructurings**


**Brady deal**

- Feb. 1991 The agreement provided for cash buyback at a 44 percent discount ($628 million), collateralized debt reduction bonds ($335 million), and new money ($89 million) combined with debt conversion notes ($447 million). The repayment terms were 30-year bullet maturity and 6.75 percent fixed interest for the interest reduction bonds, 16-year maturity including 7 years' grace with LIBOR + 7.8 percent interest for the conversion notes, and 15-year maturity including 7 years' grace with LIBOR + 1 percent interest for the new money notes.

**Bond market defaults and restructurings**

- May 2003 Swapping of about $5.4 billion of the public debt. The exchange operation created 15 maturity extension bonds and 3 new U.S. dollar–denominated benchmark bonds. The new international bonds included Collective Action Clauses. Overall participation was about 93 percent of eligible bonds.

**República Bolivariana de Venezuela**

**Bank debt restructurings**

- Sept. 1988 Interest spread reduced on February 1986 agreement, affecting $20.3 billion in debt.
- Dec. 1988 Exchange of debt for bonds outside the framework of the main negotiations.

**Brady deal**

- Dec. 1990 Agreement featured buybacks in the form of 91-day collateralized short-term notes ($1,411 million), exchange for bonds at 30 percent discount ($1,810 million), exchange at par for reduced fixed-rate interest bonds ($7,457 million), exchange for bonds at par with temporary step-down interest rates ($3,027 million), and new money combined with debt conversion bonds ($6,022 million).

**Vietnam**

**Brady deal**

- Dec. 1997 Agreement restructuring $310.9 million of principal and $486.2 million of past-due interest. For restructured principal, $20.4 million was repurchased at 44 cents per U.S. dollar, $51.6 million was exchanged for discount bonds (50 percent discount), and $238.9 million was exchanged for par fixed-interest bonds. Both bonds had 30-year maturity, but the discount
bond was repayable in a bullet payment on year 30 while the par bond had a step-up amortization schedule beginning on year 15. Also, 50 percent of the face value due of the par bond was due at maturity. The discount bond was subject to an interest rate of LIBOR + 13/16 while the par bond was subject to step-up interest rates rising from 3 percent in years 1 and 2 to 5.5 percent in years 21–30. One hundred percent of the discount bonds and 50 percent of the par bonds were guaranteed by U.S. Treasury zero-coupon bonds, and the discount bonds had a six-month rolling interest guarantee. Regarding past-due interest, $15 million was paid at closing, $294.8 million was exchanged for non-collateralized bonds with a 18-year maturity including 7 years’ grace and step-up interest rates, $21.8 million was repurchased at 44 cents per dollar, and $154.6 million was written off.

Yemen, Republic of
Bank debt restructurings
June 2001 Buyback of $362 million of principal and $245 million of associated interest under the IDA DRE. The buyback price was set at 2.94 cents per dollar of the principal amount. The IDA and the governments of the Netherlands, Norway, and Switzerland provided funding for the operation.

Yugoslavia, Federal Republic of
Bank debt restructurings
Oct. 1983 Rescheduling of $1.3 billion of maturities, including an one-year rollover of short-term bonds, due in January 1983–December 1983; new long-term money ($600 million); maintenance of short-term credit lines ($800 million).

Zaire
Bank debt restructurings
April 1980 Rescheduling of $402 million of debt outstanding as of end-1979, including arrears.
June 1984 Deferral of principal due in January 1984–April 1985 ($64 million), rescheduled under the April 1980 agreement.
May 1986 Deferral of principal due in May 1986–April 1987 ($65 million), rescheduled under the April 1980 agreement.
May 1987 Deferral of principal due in May 1987–April 1988 ($61 million), rescheduled under the April 1980 agreement.
June 1989 Deferral of principal to finance monthly payments on outstanding claims, mainly interest on arrears.

Zambia
Bank debt restructurings
Dec. 1984 Rescheduling of $74 million of maturities, including arrears as of February 28, 1983.