Petro-Dollars, LDCs, and International Banks

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FOREX and the Federal Reserve Bank of New York have a great many common interests—a healthy world economy, a well-functioning international financial mechanism, a sound international banking system, and a smoothly operating foreign exchange market. In view of this, I am pleased to have this opportunity to be with you to review some of the major developments that have a bearing on those interests and to look ahead at problems and prospects for the future. As you well know, one of the most significant developments of the past couple of years has been the advent of the "petro-dollar"—a recent and most significant addition to the vocabulary of international finance. Today I would like to focus in particular on some of the issues arising in connection with the accumulation and disposition of petro-dollar balances and their impact on international financial developments. I would also like to have a look at the position of the less developed countries (LDCs) and the role of the international banking system in dealing with these matters. These issues are timely today as we begin the new year, particularly in the light of the agreements reached in Jamaica yesterday. They are also timely for me personally since I have just returned from a trip to the Middle East, visiting central banks and monetary authorities there, and have some fresh impressions of the area that I would like to share with you.

As a very general observation, I will start by saying that my recent visit confirmed impressions of earlier trips—and impressions of other travelers to that area—that the monetary authorities of the oil-exporting countries are continuing to follow a responsible and constructive course in the handling of the massive amounts of petro-dollar balances accumulated by their respective countries. However disruptive the oil price increases have been for the world economy in general, the monetary authorities of the OPEC countries, in managing the flows of funds through their central banks, have been most careful to avoid disruptive actions that, merely because of the huge amounts involved, could have unsettling effects on the international financial markets. The magnitude of that task can best be illustrated by the fact that these authorities have to invest—and reinvest—at a rate of several hundred million dollars each week, every week of the year.

In carrying out their responsibilities, the monetary authorities in the oil-exporting countries have also recognized the desirability of cooperation with the central banks of other countries of the world. The need for central bank cooperation has been recognized, notwithstanding the basic disagreement on the question of oil prices between the oil-exporting and oil-importing countries. I am pleased to report in this regard that close cooperation has been developed between the Federal Reserve and the central banks of the OPEC countries aimed at avoiding disruptive flows of funds within our own markets, and ensuring that market mechanisms continue to function efficiently in handling such flows. The lines of communication and coordination that we have established for these purposes have been most effective and mutually beneficial.

Another general observation worth making is that the investment strategies of the various oil-exporting countries vary greatly. As a general rule, the OPEC countries have as a common objective the development of their internal economies as rapidly as possible, recognizing the finite nature of their petroleum resources and the necessity to build a broad economic base for future development. They also have as a common objective the preservation of their financial assets, pending the time when they will be needed for purposes of internal economic development. In this sense, they look upon their financial assets as savings, to be used at a later date—some sooner than later. Here, however, the similarity among the countries ends, and there are great differences among them in their investment strategies in attempting to achieve these common objectives. These differences reflect in large part the differences among them with respect to their internal development needs and absorptive capacities, as well as their gross oil receipts. Obviously, a country like Saudi Arabia, with a relatively low population density, low absorptive capacity, and relatively high oil production, will have a larger surplus than a country with a lower level of oil production or a higher absorptive capacity. Perhaps not so obvious, but just as important, is the fact that the investment strategies of these two countries will differ greatly in the light of those factors.

PETRO-DOLLAR SURPLUSES

Turning now for a look at the figures, as we all know, the overall payments surplus of the oil exporters fell sharply in 1975. Some observers now believe that the overall surplus is likely to disappear completely in a few years. In any event, it is quite clear that the magnitude of the surplus—and the magnitude of the problems arising from the surplus—are much smaller than predicted earlier. Whatever the case, I don't think we should devote too much time attempting to predict with any precision the eventual size of the cumulative surplus and the time of its peaking. There are too many imponderables to rely heavily on such long-range forecasts. The future course of oil prices, of oil production, of oil demand, as well as the level of OPEC imports, all of which are crucial elements in the equation, will be influenced by many factors, each of which can be perceived only dimly at this time. To emphasize too heavily that the total OPEC surplus is likely to disappear in the not-too-distant future may divert attention from the problems that we still face. In the same vein, the earlier forecasts of huge and never-ending surpluses may well have weakened efforts to tackle the immediate issues by making the problems seem unmanageable.

In 1975, the sharp reduction of the OPEC surplus reflected a number of factors. First of all, on the demand side, the steep recession in the industrial countries reduced industrial use of all forms of energy.[1] In addition, the relatively warm 1974-75 winter helped reduce fuel consumption for heating. At the same time, the natural market demand response to higher prices finally began to appear in significant degree. Both industrial users and individuals particularly the former, made serious efforts to economize in their energy consumption. The price elasticity of demand for oil is no doubt considerably larger in the longer run than we at first surmised, or than we have seen so far. Thus we should have some further effects along this line. Beyond the market reaction, government-led energy conservation programs have also begun to dampen oil demands. So far, these have been more effective abroad, especially in Europe and Japan, than in this country.

As a result of all these factors, OPEC oil production in 1975 fell to 70 percent of capacity,[2] the volume of OPEC oil exports declined by more than 10 percent from 1974, and the value of oil shipments fell by about 5 percent, even in the face of increased oil prices in the course of the year.[3]

On the other side of the ledger, the surge of OPEC imports was also a major factor in diminishing the surplus. Last year OPEC merchandise imports probably exceeded \$60 billion, compared with some \$37 billion in 1974 and \$20 billion in 1973. A rise in import prices contributed to this increase in dollar amount, although the rate of price increases appears to have slowed down last year. The rate of increase in the volume of OPEC imports, on the other hand, continued unabated; in 1975 the volume of imports was more than double that of two years previously.

Given the limited port facilities of the OPEC countries, this jump in their imports has been rather remarkable. Headlines emphasize the port congestion in these countries, and a visitor can indeed see the long lines of freight-

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[1] The extent of the recession is illustrated by the fact that the volume of world trade in 1975 showed the first significant drop (estimated at 6-7 percent) since the end of World War II.

[2] OPEC oil production apparently amounted to a little more than 26 million barrels per day, as against the 1973 peak of more than 30 million barrels per day.

[3] The 1975 figure for oil shipments is estimated at about \$100 billion on a transactions basis. This estimate differs from estimated cash revenues because oil payments lag shipments. This difference, which appears to have been more than \$10 billion in 1974 because of the large price increase at the end of 1973, was substantially smaller last year.

ers in the harbors waiting to unload. But a visitor to some of the OPEC countries also becomes aware of the ingenuity beginning to be shown in speeding the unloading of shipments from abroad. The use of containerized barges, floating docks, and other similar devices is spreading, although serious problems of congestion remain.

American inventiveness is playing an important role in resolving many of these problems, just as American industry is contributing to the upsurge in OPEC imports in general. On my latest visit, I was a little disappointed to observe scattered indications that United States manufacturers may not be holding their own against those of other industrial countries. Until recently at least (current figures are hard to come by), the already large United States share in OPEC imports had risen somewhat further. But I wonder whether we are making as much of an effort to participate in these rapidly growing markets as we could. A visitor to these countries is struck by the growing inroads made there by Japanese and European products and services.

With the continuing rapid growth of OPEC imports and the decline in their oil exports in 1975, the OPEC current-account surplus—on a transactions as distinct from a cash basis—appears to have been almost halved in 1975, perhaps to $35 billion from the almost $70 billion level of 1974.[4] For 1976, the prospect would seem to be for little change in this net surplus. Unless the recovery in the industrial countries gathers speed considerably faster than is now generally anticipated, OPEC oil income is likely to grow no more than some 15-20 percent (about $15-20 billion), assuming the present level of oil prices.

At the same time, it would be surprising if total OPEC imports in 1976 increase significantly more than the increase in their oil income. Even though it seems clear that the long-run import capacity of these countries is substantial,[5] a slowdown in the growth of OPEC imports is likely. Worldwide inflation has lessened, and this will keep down the rise in OPEC import prices and thus in import values. More fundamentally, a number of the "high absorber" countries are close to balance in their external accounts and are already taking steps to moderate their import expansion. Furthermore, all OPEC countries are finding that their internal development efforts are creating domestic inflationary strains that will probably cause them to slow down their development plans.

Looking at last year's surplus on a cash basis (rather than a transactions basis), the total for 1975 came in at about $30 billion. This compares with $55 billion in 1974.[6] This is the amount of the "investable surplus"—the amount that OPEC countries actually have available to make new investments abroad. For obvious reasons, it is a figure of great interest to all of us involved in the international financial markets.

The disposition of the OPEC investable surplus—or the composition of OPEC investments—has now changed greatly, both in geographic terms and in the types of assets utilized. In the first place, the accrual of the surplus itself has become much more concentrated. Saudi Arabia, Kuwait, and the United Arab Emirates accounted for the bulk of the OPEC cash surplus in 1975. Several of the OPEC countries—Algeria, Ecuador, Indonesia—swung into deficit. A few others, including Iran and Venezuela, were coming close to balance. A number of OPEC countries have in fact already entered the international financial markets as borrowers rather than investors—Algeria, Ecuador, Indonesia, Iraq, and Iran. The desire to solidify their credit standing at this early stage has been an important reason behind these moves.

As for the area distribution of OPEC investment funds, new sterling investments in the United Kingdom—as opposed to the Euro-sterling markets—appear to have stopped, although apparently there has not been any substantial disinvestment. According to the Bank of England,[7] OPEC sterling investments in the United Kingdom are estimated to have actually declined by $0.8 billion in the second and third quarters of 1975, after having risen the same amount in the first quarter. In 1974 such investments had risen by $6 billion.

OPEC placements in the Euro-currency markets have continued, but at a slower pace. For 1975 they may be roughly estimated at less than $10 billion, or about 30 percent of the investment total. In 1974, in contrast, the Euro-currency markets had received the prime share of

[4] Current account defined to include transactions in goods and services and private transfers.

[5] On this point, we should be paying more attention to the ability of the industrial countries to satisfy the growing demands for imports by these countries and to the possible strains on capacity in the industrial countries that could well develop as time goes on.

[6] OPEC grants to the LDCs are not included as part of this investable surplus; that is, they are counted as an outflow before the line is drawn to calculate the size of the surplus. Grants and other aid to the LDCs are discussed below.

[7] *Quarterly Bulletin* (December 1975).

OPEC investments, estimated at $23 billion or over 40 percent of the total.

The United States share in the placement of OPEC funds in 1975 appears to have stayed close to the 20 percent of 1974; in absolute terms such placements may be put at about $6 billion in 1975, as against $11¼ billion in 1974. At the same time, there have been significant changes in the portfolio distribution of OPEC placements in the United States, in the share of individual OPEC countries in aggregate investments, and in the maturity pattern of OPEC holdings here.

As to changes in OPEC portfolio preferences, last year there was a pronounced shift from time deposits in United States banks to investments in Government and Federal agency securities. In 1974, as much as 40 percent of OPEC placements in the United States took the form of time deposits. In 1975, such holdings appear to have remained about stationary. Aggregate holdings of Government and Federal agency securities, on the other hand, increased by more than $4 billion in 1975. The great bulk of these securities are held by the Federal Reserve Bank of New York. The Bank, as you know, maintains accounts for all of its foreign central bank correspondents and provides investment facilities for them in United States Treasury and agency securities.[8]

An even more significant change in OPEC investment patterns is reflected in the dramatic surge of equity purchases by a small number of OPEC countries in the Middle East. During the first ten months of 1975, reported purchases of equities by residents of OPEC countries exceeded $1 billion, and no doubt additional amounts were indirectly acquired through European banks.[9] I have the general impression—which cannot be substantiated by reported statistics—that for 1975 as a whole total OPEC equity investments in the United States may well be double that figure. While our statistics do not give any indication as to whether these securities have been acquired by official agencies or private investors, it is likely that the bulk of these purchases were for official accounts. These are portfolio investments and have not been made for the purpose of acquiring control of individual companies. They appear to be spread among a range of securities, and aggregate holdings of the shares of individual corporations appear to account for only a negligible proportion of their outstanding stock. I should add that these official equity purchases in the market on this scale are without precedent in the administration of the financial reserves of central banks and governments. They would appear to be a not inappropriate innovation on the part of countries such as these, who wish to find a profitable outlet for their national savings which they do not plan to draw on for many years to come. Such investments, moreover, also contribute to the basic strength of our stock market.

Another significant aspect of OPEC investments in the United States during 1975 is the increasing concentration of placements here by a relatively few countries in the Gulf area. Actually, the acquisition of securities by these countries—as reflected in holdings at the Federal Reserve Bank of New York—exceeded by a substantial margin the aggregate increase in OPEC holdings in this country. In other words, during 1975 several OPEC countries in areas outside the Middle East drew down their holdings as one would have expected in the light of well-publicized changes in their financial position.

The composition of securities held in custody for OPEC countries at the Federal Reserve Bank of New York also indicates a substantial lengthening of maturities. This is in line with an apparent lengthening of maturities of OPEC investments generally. Of the total OPEC investment portfolio in the United States at the end of 1975, long-term Treasury, Federal agency, and private securities accounted for more than one third. At the end of 1974, the comparable proportion was a little more than 10 percent.

OPEC investments in the United States, the United Kingdom, and Euro-currency markets combined thus came to about one half of the total OPEC surplus in 1975. Of the remaining $15 billion—the other half—an estimated $2 billion was "diversified" as investments in the domestic markets of countries other than the United Kingdom or the United States, such as Germany or Switzerland. The amounts of these placements are rough approximations because we have no detailed statistics on such figures.

The remainder—approximately $13 billion—was placed with international institutions, such as the IBRD and the IMF, and as financial assistance in the form of loans to other countries.[10]

[8] At the end of 1975, securities held in custody for about 130 foreign and international accounts held at the Federal Reserve Bank of New York totaled $68 billion.

[9] In 1974 the reported purchases amounted to only a few hundred million dollars.

[10] Details of financial assistance to the LDCs are discussed below.

THE PROBLEMS OF THE LDCS

As the payments surplus of the OPEC countries fell sharply, its counterpart—the overall payments position of all of the oil-importing countries—changed substantially. The current-account balance of the industrial countries as a group swung abruptly from a deficit of about $11 billion in 1974 to a surplus estimated at more than $15 billion in 1975.[11] This change reflected the rise in the industrial countries' exports to OPEC and the influence of recession in keeping down their overall imports. A second group of relatively well-off countries, the so-called more developed primary-producing countries ranging from Australia to Yugoslavia, apparently saw little change in their large current-account deficit, which in 1974 had approached $15 billion.

In contrast, the poorest group of the world's countries, the oil-importing LDCs, suffered yet another deterioration in their already large balance-of-payments deficit. In 1975 their deficit approached about $35 billion, compared with $28 billion in 1974 and $9 billion in 1973. This serious deterioration of these countries' external position reflects a combination of adverse developments—the rise in oil prices and worldwide inflation raised the price of their imports, and the recession weakened the markets for their exports, with exports falling both in value and volume terms.

The quintupling of oil prices since 1973 added an estimated $12 billion to these countries' annual oil import costs. The higher prices of their other imports, whether essential raw materials like fertilizer, or food or manufactures, added some further $25 billion to the cost of their imports. In 1974 the LDCs had been able to more than offset the higher costs of their imports from the developed oil-importing countries through higher prices of their exports, as they reaped the benefits of the 1973-74 commodity boom. But in 1975, as the commodity boom collapsed, their export prices fell. The prices of their imports, however, continued to rise. As a result, their terms of trade—the change in export prices relative to the change in import prices—deteriorated sharply in 1975 by more than 10 percent. This deterioration followed a 4 percent deterioration in 1974 that stemmed from the jump in oil import prices. The worldwide inflation also eroded the real value of the economic aid they received and reduced the purchasing power of their external reserves. This cost to them was only partly offset by the reduction in the real costs of their debt burden that inflation brings about.

The situation of the LDCs is serious, but one can no longer regard them uniformly. Within this group, a significant number of countries—ranging from Brazil to Taiwan—have been able, through a combination of circumstances since the 1960's, to make significant breakthroughs in their economic development. Their industrialization and export diversification has brought them to the point where their annual rates of growth in real incomes approach or even surpass 10 percent. The oil crisis and the recession sharply slowed their growth in 1974 and 1975. But they have a cushion of external reserves and have retained their internal momentum. As the world economy recovers, it is a reasonable expectation that these so-called middle-income LDCs will be able to resume their relatively rapid growth.

The situation is quite different for the low-income LDCs that have per capita incomes of less than $200 per annum. These countries, ranging from Bangladesh to Zaire, have a total population of one billion. Unlike the middle-income countries, most of them did not benefit from the 1973-74 commodity boom, and their growth, slow as it had been previously, came to a complete stop in 1974 and 1975. Their prospects, internal and external, are critical. According to World Bank estimates, even if total economic aid to these countries increases in money terms sufficiently to maintain its real value, the real per capita annual income growth will hardly exceed 1 percent in the remainder of this decade. This is indeed a grim outlook. The longer term outlook is particularly problematical, given the immediate difficulties these countries face in the financing of their swollen external deficits.

In 1975 the oil-importing LDCs as a whole managed to finance their deficits with only a moderate drawing-down of their external reserves, an estimated $3 billion out of a total of some $30 billion at the beginning of the year. They had to cut back the volume of their imports, apparently by more than 5 percent, but they obtained larger amounts of international assistance which may be estimated at about $17 billion, and were able greatly to increase their borrowing from private lenders, possibly to as much as $14 billion. As the recovery in the industrial countries takes hold and they increase their imports, the general expectation is that the overall deficit of the LDCs will decline. This is a reasonably safe assumption, but it is unlikely that this decline will be very great. Despite the

[11] The current account is defined to include goods and service transactions and private transfers. The current-account positions of all the major industrial countries, except Canada and Germany, strengthened in 1975. The United States experienced the largest change, as its surplus rose from $2 billion to an estimated $15 billion.

hazards of forecasting, one can estimate that LDCs will face a current-account deficit in 1976 of around $30 billion, as against an estimated $35 billion in 1975.

What are the prospects for the two main sources of financing the LDCs' deficits: official assistance and private lending?

Official financing, as I indicated, may have reached $17 billion last year, and of this IMF financing came to about $2 billion. This took place partly through the special oil facility, to which both OPEC and OECD countries contributed,[12] and partly through regular IMF channels. The oil facility is due to be phased out, and therefore primary reliance will have to be placed on the basic IMF quota facilities—which were expanded by the Jamaica agreement yesterday—and the new plans for an IMF trust fund and an expanded compensatory financing facility. It seems clear that IMF financing will have to play an important role, as was recognized at the Jamaica meetings.

The prospects for further growth in total assistance provided by both the OECD and the OPEC countries, bilaterally or multilaterally, are not very bright. The OECD countries as a whole appear to have somewhat increased their total aid in monetary terms, although as a proportion of their GNP their aid remains substantially below the target agreed upon for the 1970's.[13] Little change appears on the immediate horizon.

The OPEC countries expanded their total assistance to over $9 billion in 1975 from $7 billion in 1974, including their actual contribution ($2.6 billion in 1975 and $1.8 billion in 1974)[14] to the IMF oil facility, which is utilized by developed as well as developing countries. This total assistance in 1975 came to about 5 percent of their GNP and 9 percent of their oil exports. About a third of this aid total was in the form of grants and loans at concessionary interest rates. Bilateral aid appears to be an increasing proportion of the total, accounting for about one third. With respect to multilateral aid, not counting the IMF oil facility, OPEC resources appear to be increasingly channeled through special institutions set up and administered by OPEC countries.[15] While the bulk of total concessionary aid by OPEC countries continues to be given to a few Arab countries, the proportion directed to non-Arab low-income developing countries is rising.

As OPEC surpluses diminish, only a few OPEC countries will be in the position of being able to provide assistance out of external revenues that are not immediately needed domestically. In 1975 the larger part of OPEC concessionary aid was provided by three countries, Saudi Arabia, Kuwait, and the United Arab Emirates. The concentration is less if loans at market rates are included. Several OPEC countries, including Iran, have now scaled down their external assistance. While the OPEC countries by and large recognize their international responsibilities in this regard, their foreign-aid programs will undoubtedly come under increasing pressure from competing domestic needs. In 1976 their total aid disbursements are likely to rise somewhat further, simply because their aid commitments continued to rise through the first part of last year. But beyond that, it would hardly be realistic to expect further substantial growth.

THE ROLE OF THE INTERNATIONAL BANKING SYSTEM

The other main source of financing the LDCs deficits is the private sector. When the world community first faced the problem of financing the greatly enlarged payments deficits of the oil-importing countries in early 1974, there were serious questions of how large a role the private markets could play. Areas of concern included the possible instability of the new OPEC deposits, the restraints on banks of declining capital-deposit ratios, the creditworthiness of borrowers, and the advisability of private lenders engaging in large balance-of-payments

[12] For 1974 and 1975 total contributions, not all drawn down, to the IMF oil facility totaled $7¼ billion, of which almost $6 billion came from OPEC countries.

[13] Grants and concessionary loans, so-called official development assistance, appear to be about ⅓ percent of GNP for the OECD countries as a whole, as against the 0.7 percent target.

[14] These figures are based on estimates of actual disbursements; total commitments for financial assistance are considerably greater. Total commitments by the OPEC countries to provide financial assistance of all forms—concessional and nonconcessional—to the nonoil LDCs, according to a report by UNCTAD, amounted to $14.9 billion in 1974 and $10.7 billion in the first six months of 1975. ("Financial Cooperation between OPEC and Other Developing Countries", October 29, 1975.)

[15] By latest count the following official institutions have been established: Arab Bank for Economic Development in Africa, Arab Bank for Investment and Foreign Trade, Arab Fund for Economic and Social Development, Arab Fund for the Provision of Loans to African Countries, Arab Investment Company, Arab Fund for Technical Assistance to Arab and African Countries, Arab Petroleum Investment Company, Inter-Arab Investment Guarantee Corporation, Islamic Development Bank, Islamic Solidarity Fund, League of Arab States Emergency Fund.

financing.[16] The international banking system did indeed experience some serious strains in the middle months of 1974, but these stemmed largely from the turmoil and excesses in the foreign exchange markets at that time. In any case, the shock of a few bank failures (Franklin, Herstatt) led to an improvement in market practices in general. Margins in the Euro-currency markets, which competition had reduced to abnormally low levels, were widened and lending terms were tightened generally. The role of some marginal lenders was reduced and a more careful appraisal of credit risks became a general practice. At the same time OPEC countries' deposits did not turn out to be volatile and the creditworthiness of many borrowers was strengthened by enlarged official financing facilities and by their constructive domestic policies.

International bank credit expansion in the Euro-currency markets and by banks in the United States slowed down markedly in 1975. The total of publicly announced new Euro-currency credits came to some \$20 billion in 1975 (as against \$29 billion in 1974), and loans extended to foreigners by United States banks totaled some \$3 billion (as against almost \$12 billion in 1974). In contrast, activity in the international bond markets accelerated to some \$18 billion in 1975, from only \$7 billion in the preceding year.

Within the reduced total of international bank credit in 1975 the oil-importing LDCs were able to expand their international borrowings quite substantially. They obtained over \$8 billion in publicly announced Euro-currency credits, as against some \$4½ billion in 1974. From banks in the United States these countries borrowed some \$5 billion, about the same as in the preceding year. The oil-importing LDCs also marketed about \$½ billion in international bonds in 1975.

From now on private lending to the LDCs will come under increasing restraints, and it appears doubtful that they will be able to raise anywhere near the same record amounts in 1976. The restraints are likely to come both from the position of the borrowing countries and from the side of the lenders. The current debt service payments of the LDCs are already very high; they may be estimated at over \$10 billion a year on public and publicly guaranteed debt alone. The indebtedness of some of these countries is now so large that their interest and debt repayments exceed 20 percent of their total foreign exchange receipts. In some cases there is a clear need for debt restructuring and, as you know, discussions along these lines have in a few cases been under way for some time. A large number of these countries undoubtedly can now expect little if any help from private lenders. They are entirely dependent on official financing.

Some of the middle-income LDCs retain their relatively good credit ratings and will in all probability want to continue to raise funds from private lenders. In 1976, however, they may face increasing competition from other borrowers. These will include private borrowers in the industrial countries as the recovery proceeds, some of the OPEC countries that are returning to the borrowing side, the various communist countries that entered the market in large volume last year, and finally some of the OECD countries themselves.

The international banking system can thus expect a growing demand for loans from various types of borrowers this year. And the question has been raised as to the extent to which it will be able to accommodate these demands. As far as the Euro-currency markets are concerned, it would seem that a loan expansion of about the same magnitude as in 1975 is entirely possible. Because of increased domestic demands in the United States, banks may not wish to channel as much of their funds to the Euro-markets through their branches. But as happened so often before, a reduction in the flow from the United States is likely to be replaced by other inflows. All in all, despite some continuing problems, the Euro-banks should be able to continue to accommodate good borrowers. The maturity of deposits has lengthened, equity positions have strengthened, and earnings remain in general reasonably healthy, notwithstanding increased provisions for loan losses. Data for some of the major United States banks illustrate this position. Thus for the New York money market banks the capital-funds-to-deposits ratio, which turned up in 1975 after having declined sharply in the two preceeding years, reached 6.6 percent at the end of September 1975, as against 5.9 percent at the end of 1974. Moreover, the net income of these banks for the first nine months of 1975 increased by a remarkable 18.2 percent, notwithstanding record charges against income to provide for possible loan losses. The earnings picture for the fourth quarter has, of course, been much weaker as actual loan charge-offs and loan loss provisions have increased sharply. Nevertheless, most of the major United States banks have recorded substantial earnings gains for 1975 as a whole, and have entered 1976 with stronger loan loss reserves than a year earlier.

[16] I reviewed these in an address on "International Banking" before the Banking Law Institute in New York City on May 8, 1975. See *Monthly Review* (June 1975), pages 122-29.

THE SOUNDNESS OF BANKING SYSTEMS

Banking systems throughout the world have remained sound despite the recent tests to their resilience and the possibility that lending problems may arise in the future, whether with respect to the LDCs or to some other source in this uncertain world. These tests have spurred bank managements and national supervisory authorities to take actions to ensure that operating procedures will provide for adequate liquidity and solvency in the face of a constantly changing banking environment. A number of countries are revising their banking laws or otherwise modernizing their supervisory apparatus in the light of the increasing importance that international transactions have assumed in the banking business. In this country, for example, our examiners' training now gives added emphasis to the international aspects of bank operations, and our supervisory authorities have been working with banks to develop minimum standards for operational safeguards in foreign exchange trading.

Central banks of the Group of Ten countries, along with other supervisory authorities from these countries, have also been working as a committee to provide more secure banking systems. The committee, in meetings at the Bank for International Settlements, has agreed on the need for international cooperation in the supervisory field; representatives have exchanged and discussed information on national supervisory developments and have agreed to cooperate in an "early warning system" to heighten official awareness of banking difficulties.

I think we can all agree that the health of the international banking system is vital for the health of the world economy as a whole. We have managed to overcome some difficult obstacles in the last few years. With the newly developed cooperation of the monetary authorities in the oil-producing countries, we have been able to cope with the financial problems of petro-dollar accumulations and flows. So far, we have managed also to cope with the problems of financing the LDCs; while we may be approaching the limits of these efforts by the private sector for some of the LDCs, the Jamaica agreements provide for further official financing possibilities for these countries. All of us involved, private and central bankers alike, and whether in OECD, OPEC, or LDC areas, must strive to ensure that the international banking system retains its basic strength and soundness, while adapting to the changing needs of changing times.