In Brief
Economic Capsules

Currency Diversification and LDC Debt

Between 1979 and 1982, the nonoil developing countries (LDCs) borrowed about $137 billion from commercial banks worldwide, virtually all in terms of dollars. Had these countries diversified the currency composition of their borrowings to correspond broadly with the currency composition of their trade, they would have incurred substantial savings in interest payments as well as in the conversion value of their principal.[1]

To estimate these savings, weights were assigned to various major currencies. The weights were based on the composition of nonoil LDC trade in 1980.[2]

The relative cost of borrowing was determined by comparing three-month average Eurodollar interest rates from 1979 to 1982 with three-month average Euro-rates for the trade-weighted mix of currencies. The interest rate for the mix of currencies was lower in each year (Table 1).

Relative exchange rate changes are reflected in changes in the level of the trade-weighted index of the

Table 1

Average Annual Rates of Interest
In percent

Year	Three-month Eurodollar interest rates	Three-month Euro-rates for a trade-weighted mix of currencies
1979	11.93	11.03
1980	13.96	13.36
1981	16.80	15.32
1982	13.10	12.45

Table 2

Effect on Principal of Borrowing in a Trade-Weighted Mix of Currencies

Year	Trade-weighted index (1978 = 100)	Net borrowings from banks ($ billion)	Cumulative borrowings ($ billion)	Conversion value of cumulative borrowings ($ billion)
1979	101.2	35	35	35.4
1980	101.3	38	73	73.9
1981	96.0	41	114	109.4
1982	91.6	23	137	125.5

[1]To the extent that borrowing and rolled-over maturing debt took place in currencies other than dollars, our estimates may overstate the benefits. Nevertheless, data for five major nonoil LDC borrowers indicate that only 1.4 percent of syndicated loans to these countries in 1980 took place in currencies other than dollars. Although this percentage has tended to increase in recent years, totaling 11.9 in 1982, it still lags well behind the world average. For example, the percentage of all syndicated loans in nondollar currencies was 10.6 in 1980 and 20.8 in 1982. Excluding the five major nonoil LDC borrowers, these percentages were 12.8 in 1980 and 30.1 in 1982. The five nonoil borrowers include Mexico, Brazil, Argentina, Korea, and the Philippines.

[2]Weights were based on aggregate nonoil LDC imports. Weights based on aggregate exports in the same year would have been almost identical. Over the past five years, the trade patterns have been reasonably stable. In our calculations, imports from Belgium and Denmark were attributed to the German mark. Imports from OPEC countries, from each other, and from those countries not accounted for in the currencies specified below were attributed to the dollar. The trade weights in percentage terms were: U.S. dollar 67.0, Japanese yen 10.5, German mark 8.5, French franc 4.8, pound sterling 4.6, Italian lira 3.0, Dutch guilder 1.6.

mix of currencies *vis-à-vis* the U S dollar (1978 = 100) With dollar depreciation during 1979 and 1980, the index rose slightly, *i e* appreciated, against the dollar in these two years By contrast, the strengthening of the dollar during 1981 and 1982 caused the index to fall, *i e* depreciate, by roughly 5½ percent and 4½ percent, respectively, in each of these years

Between 1979 and 1982, nonoil LDC cumulative net borrowings from banks amounted to $137 billion Had this borrowing been denominated in the trade-weighted mix of currencies, its conversion value at end-1982 would have been about $125 5 billion (Table 2) This would have represented a savings of about $11 5 billion or 8½ percent over borrowing solely in U S dollars

The interest rate on the trade-weighted mix of currencies was 1 48 percentage points lower than the comparable dollar rate in 1981 and 0 65 percentage points lower than that in 1982. Exchange rate changes reduced the value of the trade-weighted index against the U S dollar by 4 percent between 1978 and 1981 and by 8 4 percent between 1978 and 1982 As a result, interest payments on cumulative bank borrowings by the nonoil LDCs would have been lower by about $2 billion in 1981 and in 1982 (Table 3)

If maturing debt had also been rolled over into the trade-weighted mix of currencies, the savings effects would have been even greater Additional savings would have amounted to $13 billion on the principal at end-1982 and roughly $2 billion on the interest payments in 1981 and in 1982

Table 3

Effects on Interest Payments of Borrowing in a Trade-Weighted Mix of Currencies

In billions of dollars

Year	Average cumulative borrowings	Pure interest savings	Exchange rate savings (loss)	Total savings*
1979	17 5	0 16	(0 02)	0 13
1980	54 0	0 33	(0 09)	0 23
1981	93 5	1 39	0 58	1 96
1982	125 5	0 82	1 31	2 13

Average cumulative borrowings were calculated on the assumption that the borrowings were distributed evenly through the year Pure interest savings measures the gain from borrowing at a lower interest rate using the trade-weighted mix of currencies Exchange rate savings (loss) adjusts the interest payments for movements in the trade-weighted index against the U S dollar since 1978

*Because of rounding, figures may not add to totals

In total, these estimates suggest that the combined savings to the nonoil LDCs in terms of lower interest costs and exchange rate gains of diversifying their new and maturing bank debt between 1979 and 1982 could have amounted to over $30 billion

Andrew Mohl and Dorothy Sobol