IMF SURVEY
www.imf.org
International Monetary Fund
VOLUME 28
NUMBER 8
April 26, 1999

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Press briefing

IMF staff report considers role of private sector in preventing and resolving financial crises

Finding ways to better involve the private sector in forestalling financial crises and, when preventive measures fail, helping to limit their damage and duration are among the more complex challenges in strengthening the international financial system. At a press briefing on April 15, Jack Boorman, Director of the IMF's Policy Development and Review Department, highlighted the main findings of an IMF staff paper, *Involving the Private Sector in Forestalling and Resolving Financial Crises.* Along with the staff paper, the summing up of the IMF Executive Board discussion on this topic was also released (see box, page 114). Boorman stressed that the staff paper and the summing up should be viewed as progress reports rather than final products. These documents provide an interim assessment of the framework for involving the private sector in crisis prevention and management and identify practical approaches that are already proving to be workable, as well as concrete actions that could be taken by member countries, creditors, the IMF, and the international community as a whole.

Jack Boorman, Director of the IMF's Policy Development and Review Department, at the press briefing

It is clear, said Boorman, that there is no magic solution and that the final product is not going to be a set of rules, but rather a set of principles that will guide the activities of all affected parties in working with individual cases. It is also evident that there will never be a single or clear-cut way to resolve crises. This, said Boorman, implies two things: First, a very high premium needs to be put on preventive measures that can be put in place to keep stress on a country's external situation from unwinding into a crisis. Second, in a crisis,

(Please turn to the following page)

Interim Committee meeting

Ministers to focus on ways to strengthen international financial architecture

Carlo Azeglio Ciampi, Minister of the Treasury of Italy

A variety of initiatives to strengthen the architecture of the international monetary system will be a primary focus of the meeting of the Interim Committee of the IMF's Board of Governors, which is being held in Washington on April 27. In addition, the Interim Committee will review recent developments in the world economy, particularly the policy responses to the crises that have affected East Asian countries, Russia, and Brazil; progress in the Enhanced Structural Adjustment Facility (ESAF) and the initiative for the Highly Indebted Poor Countries (HIPC); and IMF assistance to post-conflict countries. The Committee is also expected to discuss ways in which the international community can most effectively evaluate the regional impact of the crisis in Kosovo, coordinate the humanitarian effort, and start preparing for reconstruction.

The Committee comprises 24 finance ministers and central bank governors of the IMF and is chaired by Carlo Azeglio Ciampi, Minister of the Treasury of Italy. The main issues facing the Committee were addressed by IMF *(Continued on page 116)*

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Involving the private sector in crisis prevention

(Continued from front page) everything possible needs to be done to find a cooperative and voluntary resolution that takes account of the interests of both debtors and creditors.

If there is a single message to come from the staff and the Executive Board, it is that borrowers and creditors alike must do more to prevent crises.

Involving the private sector

Much of the analysis in the staff paper was motivated by an attempt to address the concern of many players in the official sector that providing large official financing to a country in crisis opened the door for the private sector to exit the country without loss. The possibility of a "bailout" of the private sector from poor lending or bad investment decisions can be damaging for the operation of markets, in the sense that it could lead creditors to assume that whatever happened, they were likely to be repaid. Such an assumption, Boorman noted, is indeed harmful to markets if it weakens the incentives of private players to assess risk more diligently, or if it leads to overlending—which has occurred in a number of the crisis countries—or lending on inappropriate terms.

Boorman emphasized that in no case in the recent crises has there been a wholesale bailout of the private sector. Citing estimates released by the Institute of International Finance, Boorman said private investors, banks, bondholders, and others have lost some $350 billion in the three Asian crisis countries and in Russia. Yet, there is, indeed, a bailout problem, he insisted, and in a number of recent crises, it has been concentrated at the short end of the market, including the interbank market where creditors can exit—and have done so— in crisis situations. Accordingly, IMF staff have concentrated on issues related to short-term debt but in the context of assessing the vulnerabilities in a country's overall debt structures.

Prevention

If there is a single message to come from the IMF staff's work and the Executive Board's discussion, Boorman suggested, it is that borrowers and creditors alike must do more to prevent crises. He cited several conclusions reached by the Board:

- National authorities should intensify their efforts to maintain an appropriate debt structure—in particular, a structure that is not too heavily weighted toward short-term credit. The authorities also need to improve early warning systems to detect signs of market and economic instability.
- Measures should be considered to eliminate the market bias that may exist in favor of short-term interbank credit lines.
- IMF staff should continue to assist countries in establishing systems for frequent monitoring of private sector indebtedness, and the IMF should intensify its surveillance of countries' debt structures, the use of derivatives in those debt structures, off-the-books liabilities, and other items that can increase a country's vulnerability.
- Countries should maintain effective communication with private capital markets.

Finally, Boorman said, the IMF is exploring better ways of dealing with the private markets. There is also a need, he said, to improve the environment for private risk assessment and decision making to ensure efficient and realistic pricing of debt.

Resolution

Even a strengthened system will be subject to occasional crises. In extreme situations, if preventive mechanisms put in place fail to deliver enough support or if efforts to reach agreement on a voluntary debt restructuring fail and pressures in the external accounts do not abate, countries may need to consider additional measures. Creditors and the international financial community may also need to take action. The IMF Executive Board's discussion, Boorman said, included several conclusions in the area of crisis resolution:

- Governments should modify certain standard provisions in international bond contracts, for example, by introducing provisions for the modification of terms by qualified majorities of bondholders and steps intended to reduce the likelihood of litigation by dissident bondholders in the event of a default.
- Governments should consider establishing contingent credit lines with commercial banks.
- Governments should explore with their creditors the possibility of creating debt instruments that can be

IMF Executive Board discussions

The IMF Executive Board, which is chaired by the Managing Director, is responsible for conducting the business of the IMF, including the formulation of new policies, approval of financial operations, and country consultations.

As Jack Boorman explained during the press briefing, it is the practice in the IMF that when the Board discusses a topic, the staff prepares a paper containing background material as input to the discussion. These staff papers present an analysis of the issue under discussion and proposals for the Board's consideration.

At the end of a discussion, the chairman issues a summing up, which presents the conclusions of the Board.

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designed to shift risk in a crisis. The private sector has already done a lot in this area, Boorman said, and governments could learn much from this experience.

- IMF staff should continue to study instruments that might be introduced to reduce the threat of destabilizing capital outflows from a member country.
- The IMF should continue to examine its own policies on lending to countries that are in arrears on their debt to private creditors, so that the IMF, in appropriate circumstances, could assist a country that has been unable to avoid default.

Collaborative approach

The IMF staff paper presents a number of proposals, Boorman said, but he emphasized that while the report provided input to the Executive Board's discussion, it does not necessarily represent the position of the IMF. Rather, these proposals are to be regarded as part of a work in progress calling for the participation of all interested parties. In response to a question about objections from some elements of the private sector to ideas put forward in the staff report—such as amending bond contracts—Boorman said everyone is basically searching for the same thing: ways to reduce the prospect of crises and to foster a cooperative resolution of debt problems when crises do occur. One way to do that would be to introduce mechanisms, such as majority voting, into bond contracts that provide for a country in financial distress to approach its creditors as a group for resolution and debt restructuring in some mutually agreeable way. Without such mechanisms in place, a country that is frozen out of the bond markets and cannot make good on its debt may be sued by its creditors. Even the threat of litigation can inhibit a country's prospects for adjustment and implementation of policy reform.

What we are looking for, Boorman said, is a collaborative way of getting a debtor and its creditors together under a system that would allow the bondholders as a group to assess the situation of the country in distress and come to conclusions about what is necessary to see the country through the situation. This may involve a stretching out of maturities, a lengthening of payment periods, and other measures. The IMF staff's view is that if this process can be done in a nondisruptive way, it is better both for the bondholders and for the country. The bondholders will be better off if the country is not forced through an extended period of distress. The country is obviously better off if it can get on with adjustment and reform rather than facing protracted litigation from a variety of bondholders.

Responding to a question about the apparent failure of the private sector to respond to similar initiatives introduced in the wake of the Mexican financial crisis in 1994–95, Boorman acknowledged that progress has been slow. However, he said, in the last two years, the world has gone through a quite different and more severe shock than was the case in the Mexican experience. For one thing, the markets recovered relatively quickly from the events of 1994–95, and the official community was perhaps not forceful enough about pushing necessary reforms. The Asian crisis, in contrast, its spread to many parts of the rest of the world, and what has happened in Russia and Brazil—all these have convinced people who may earlier have been undecided that it would be preferable to have mechanisms in place to help smooth the situation when a crisis strikes.

There has been a sea change in attitude about getting on with these efforts, Boorman observed. The international community is far more seized with these issues than it was in the aftermath of the Mexican crisis, and it will have staying power on them. There is also a considerable amount of common ground between the official community and the private sector. This is not to say it is going to be easy, because there are different views on many issues. However, he concluded, it is possible to focus on these perceptions of difference and talk them through. Progress is possible, because we are searching for the same thing—ways to deal collaboratively with crisis and stress situations. ■

Boorman (center) responds to questions from the press after the briefing.

The text of *Involving the Private Sector in Forestalling and Resolving Financial Crises*, by the IMF's Policy Development and Review Department, with the Chairman's summing up, is available on the IMF's website (www.imf.org). The transcript of Jack Boorman's press briefing is also available on the website.

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Interim Committee meeting

(Continued from front page)
Managing Director Michel Camdessus at a press conference on April 21 (see page 118).

International financial architecture

Focusing on the reform of the architecture, Camdessus said "It is now time to go from the broad design to more specific actions." He observed that one of the outcomes of the Asian crisis was that it had given a powerful impetus to proposals to strengthen the international monetary system. It was important now to create a system that could better serve the needs of people everywhere, he said, and he emphasized that the strengthening of social policies is also a vital complement in the reform of the international monetary system.

Andrew Crockett, General Manager of the Bank for International Settlements (left), and Hans Tietmeyer, President of the Deutsche Bundesbank, at press briefing following a meeting of the Financial Stability Forum

The Interim Committee, in its discussion of means of strengthening the international financial architecture, is expected to focus on five areas:

• *Forestalling and resolving financial crises.* Greater involvement of the private sector is seen by the Interim Committee as being of critical importance in preventing and resolving crises and will be discussed at its meeting. Two papers on this issue were released on April 15 at a press briefing conducted by Jack Boorman, Director of the IMF's Policy Development and Review Department (see page 113). The Committee will also consider proposals to establish a contingent credit line in the IMF and will review the issue of IMF lending to countries in arrears to private creditors.

• *Institutional reform and strengthening the Interim Committee.* Several proposals have been advanced to strengthen the Interim Committee, including through its eventual transformation into a policymaking Council of the IMF's Board of Governors. At his April 21 press conference, Camdessus observed that this change was already provided for in the IMF's Articles of Agreement and that the only question was one of timing.

• *Orderly liberalization of capital movements.* At its October 1998 meeting, the Interim Committee agreed that introducing or tightening capital controls was not an effective means of dealing with fundamental economic imbalances. It asked the IMF Executive Board to review experience with the use of such controls and the circumstances under which they might be appropriate. It also noted that the opening of the capital account must be carried out in an orderly, gradual, and sequenced manner. These issues are due to be considered further at the Committee's forthcoming meeting.

• *International standards and IMF surveillance.* The Committee will consider the recent strengthening of the Special Data Dissemination Standard (SDDS) by setting a new standard for data on international reserves (*IMF Survey*, April 5, page 107). It will also review progress toward developing a code of good practices in monetary and financial policies and a manual on fiscal transparency. A progress report on developing international standards and IMF surveillance was released on April 22 and was also made available on the IMF's website.

• *Transparency.* At its previous meeting at the time of the 1998 Annual Meetings, the Interim Committee recognized that "greater transparency and reporting by both the public and private sectors are critical for better functioning financial markets" (*IMF Survey*, October 19, 1998, page 319). At the same time, the Committee recognized that the IMF itself was contributing to transparency through greater openness concerning its own policies through the release of Public Information Notices (PINs), as well as the broader publication of the Letters of Intent and Policy Framework Papers underpinning IMF-supported programs.

World Economic Outlook

The discussions of the Interim Committee will take place against the background of the IMF staff's latest review and projections in its *World Economic Outlook* report. The press version of the report was released on April 20 and discussed that same day at a press conference by Michael Mussa, Director of the IMF's Research Department.

In his opening comments, Mussa highlighted three main elements of the report.

• The world growth forecast of 2.3 percent for 1999 is little changed from the previous year. Stronger growth forecasts for the United States, Canada, Australia, Korea, Malaysia, and Thailand offset weaker forecasts for Japan, Latin America, and a number of European countries.

• The balance of risks in the current forecast for 1999 is essentially even. This represents a considerable change from previous forecasts in October and December 1998, when the balance was decidedly on the down side. In particular, Brazil has enjoyed a remarkable restoration of confidence in its economy. Also, capital flows to emerging market economies appear likely to recover.

• In its forecast for the year 2000, the *World Economic Outlook* projects a global recovery of output to 3.4 percent for the year, about 1 percent stronger than for 1999. The picture, however, is clouded by a number of factors, including the likelihood of a slowing of growth in the United States, uncertain prospects for a recovery in Europe and Japan, and developments in

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developing and transition economies. (A full report on the *World Economic Outlook* will be published in the next issue of the *IMF Survey*, dated May 10. The text of the report is available on the IMF's website (www.imf.org).)

Other issues of concern

Following its discussion of the architecture and the world economic outlook, the Committee will also consider strengthening the initiative for the Highly Indebted Poor Countries (HIPC) and the financing of the Enhanced Structural Adjustment Facility (ESAF); the IMF's assistance to postconflict countries; and the regional economic impact of the Kosovo crisis.

An important area of concern will be that of debt relief for the poorest countries. At his press conference, the Managing Director noted that there is now a broad consensus in favor of taking further steps to relieve debt. Issues that are to be addressed concern the amounts that the larger IMF members and bilateral creditors would be able to contribute; how these resources should be allocated; and whether, in allocating resources, members should seek to provide more assistance for the 23 countries already identified for debt relief or to broaden the list of countries that would benefit from relief.

Preliminary meetings

The Interim Committee deputies met for the first time on April 13 at IMF Headquarters under the chairmanship of Mario Draghi of Italy to review the issues that would be considered by the ministers two weeks later.

The newly established Financial Stability Forum, chaired by Andrew Crockett, General Manager of the Bank for International Settlements, held its first meeting on April 14 at IMF Headquarters. The establishment of the forum was endorsed by the finance ministers and central bank governors of the Group of Seven industrial countries at their Bonn meeting on February 20, following a proposal by Hans Tietmeyer, President of the Deutsche Bundesbank (*IMF Survey*, March 8, page 66). The forum, which is to meet regularly, is intended to promote more formal coordination among finance ministers, central bankers, and other financial regulators to promote international financial stability, improve the functioning of the markets, and reduce systemic risk.

At a press briefing with Tietmeyer following the initial meeting, Crockett said that the forum was not designed to act as a crisis-management center but would review areas of vulnerability on an ongoing basis and seek to identify concerns in specific areas. In particular, he said, in its early stages the forum would set up working groups to focus on highly leveraged institutions (hedge funds), which have the potential to create concern if they get into exposed situations; offshore financial centers; and the potential problems that might be created for countries by short-term capital flows.

Development Committee

The meeting of the Interim Committee will be followed, on Wednesday, April 28, by that of the Joint Ministerial Committee of the IMF and the World Bank on the Transfer of Resources to Developing Countries (Development Committee). The meeting will be chaired by Tarrin Nimmanahaeminda, the finance minister of Thailand. ■

Available on the web

News Briefs

99/16, April 7. IMF Completes Review and Approves Credit Disbursement for Thailand

99/17, April 7. IMF Completes Review and Approves $245 Million Credit Tranche for Korea

99/18, April 22. IMF Releases Experimental Case Studies on Transparency Practices

Public Information Notices (PINs) are IMF Executive Board assessments of members' economic prospects and policies issued—with the consent of the member—following Article IV consultations, with background on the members' economies; also, assessments issued following policy discussions in the Executive Board at the decision of the Board. Recently issued PINs include

99/29 Grenada, April 2
99/30 Cambodia, April 6
99/31 St. Lucia, April 8
99/32 Poland, April 8
99/33 Indonesia, April 13
99/34 Yemen, April 15
99/35 Cameroon, April 15
99/36 IMF Takes Additional Steps to Enhance Transparency, April 16

Letters of Intent and Memorandums of Economic and Financial Policies are prepared by a member country and describe the policies that the country intends to implement in the context of its request for financial support from the IMF; and following policy discussions in the Executive Board at the decision of the Board. Recent releases include

Thailand, Letter of Intent, April 6
Ukraine, Letter of Intent, April 9
Uruguay, Letter of Intent, April 12
Bulgaria, Letter of Intent, April 14
Zambia, Letter of Intent, April 19

Full texts are available on the IMF's website (www.imf.org).

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Camdessus outlines issues that will be focus of Interim Committee discussions

Following are edited excerpts from the opening statement by IMF Managing Director Michel Camdessus at his press conference on April 21. The complete text of the press conference is available on the IMF website (www.imf.org).

As usual, the Interim Committee will review the world economic outlook and recent developments. It will focus particularly on the policy response to recent crises in Asia, Russia, and Latin America.

Second, it will take up the issue of strengthening the architecture of the international monetary and financial system. It is now time to go from the broad design to more specific action.

Then—and there is growing interest in this issue—there is the question of how to strengthen both our initiative in favor of the highly indebted poor countries (HIPC) and the Enhanced Structural Adjustment Facility for the poorest countries and its financing.

Michel Camdessus

Support for Kosovo

We will also discuss strengthening our actions for countries in postconflict situations. We will certainly discuss the issue of Kosovo and how the international community can, first, evaluate the regional impact of this crisis and coordinate the humanitarian effort and, second, start preparing for reconstruction. This is a heavy agenda and I will say a few words on each of these items.

Concerning the economic outlook, we have come a long way since last October. Now the climate is distinctly better. Of course, 1999 does not offer the prospect of stellar growth; as a matter of fact, growth will be a little below 1998, which was not bright. But we recognize the prospect for some acceleration of growth, and we foresee a significantly better year for 2000—3.4 percent growth, instead of 2.3 percent—and also the prospect of sounder growth, inasmuch as program reforms in the countries hit by the crisis, if implemented, have the potential to establish the growth pattern of these countries on a much sounder basis. But there are still parts of the world with difficulties and problems. Latin America as a whole will be in a recession, even though in Brazil and in the Latin American countries in general the situation today is much brighter than it was two months ago. We believe that growth could resume in that part of the world later this year, with a rapid pickup and recovery at the end of 1999 and the beginning of 2000. There are also signs that capital flows to the emerging markets are beginning to recover.

So, the situation is better, but there is no room for complacency. A lot will depend on the quality of and the perseverance in continuing with the policies of adjustment and reform.

The discussion in the Interim Committee will also focus on how the three major currency blocs will distribute among themselves the responsibility for maintaining world demand at a proper level. The discussions will also focus on the exchange rate relationship among major currency blocs and on exchange rate regimes in emerging countries.

On the reform of the international financial architecture, I can say that possibly one of the good things that has come out of the crises in Asia is the powerful impetus for proposals to strengthen the international monetary system. On these principles—as well as on pursuing the liberalization of capital markets—there is a broad consensus.

The question now is how to proceed from this uneven consensus on the big principles to specific and quick action. Fears are expressed that with the improvement of general economic conditions in the world, the impetus for changing the system could be less obvious. I do not think this is the case. Every day demonstrates that the interest in action is there. But a word of caution about the word "architecture": It may not describe exactly what we are doing. We are seeking to create a system that could really better serve the needs of people everywhere. This implies that we should continue striving to integrate into this globalized world countries that have so far not achieved such integration. We must not forget either that the strengthening of social policies is a vital complement to the reform of the international monetary system.

Debt Relief

There is now widespread support for more debt relief for the poorest countries. I believe there is a broad consensus that the time has come to adopt further steps to relieve debt. Many questions are, however, still unanswered: How much are major shareholders of our institutions and bilateral creditors ready to pay toward this effort? What is the best way to allocate these resources? Should we, in allocating the resources, try to have a deeper alleviation of the debt of the 23 countries already identified for debt relief? Or should we utilize the resources to broaden the list of countries that could benefit from it? My personal inclination would be to broaden the list. If we have learned one thing about debt relief, it is not so much that the amount of debt reduction matters—it matters a lot. What matters even more is the quality and duration of the economic effort that must support the debt relief and create change for the better. Money should be spent on debt relief in a way that creates incentives for countries to continue to persevere with adjustment and reform. ■

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Experts discuss millennium 'bug' implications, describe IMF role as crucial

With only 250 days left in 1999, what have IMF member countries been doing to prepare for the Year 2000 "bug" (Y2K), and how can the IMF best help them? In recent years, the IMF has been busy helping member countries and the global financial community deal with various financial crises. However, it has not ignored warnings that global problems are likely to arise on January 1, 2000, when computers around the world may erroneously read the new year in the standard two-digit year field as 1900. The IMF recognizes that it has a particular interest in appraising the Y2K readiness of systems that affect macroeconomic policies directly and has been discussing the issue for some time.

On April 13, the IMF's Bureau of Computer Services sponsored a seminar for IMF staff and Executive Directors. Leading Y2K experts were invited to participate and share information on the implications of Y2K for the global economy and to offer their assessments of the likely consequences of countries' failure to take remedial action or develop contingency plans. IMF First Deputy Managing Director Stanley Fischer opened the seminar by noting that the IMF management strongly supported the need to increase members' awareness of the risks associated with the problem, including the risks to the operation of essential services that affect the day-to-day functioning of members' economies (that is, "mission-critical" systems) and their interaction with others in the world economy.

The four keynote speakers—John Koskinen, Chair of U.S. President Bill Clinton's Council on Year 2000 Conversion; Edward Yardeni, Chief Economist, Deutsche Bank Securities; Tim Shepheard-Walwyn, Chairman of the Global 2000 Coordinating Group; and Lou Marcoccio, Research Director of GartnerGroup—offered both general and country-specific information and were united in their view that the macroeconomic impact of Y2K could be devastating if countries do not take the time remaining in 1999 to address the problem.

Nature of the problem

Koskinen noted that initially Y2K was viewed widely, and incorrectly, as an information technology problem rather than as a management or business problem—a point that the other three speakers echoed strongly. Policymakers must recognize that addressing the Y2K issue involves evaluating and managing risk, perception, and behavior. The key to Y2K, Koskinen said, is understanding the nature of the problem and developing contingency plans to work around it.

Is everybody ready?

Most countries got a late start dealing with the issues posed by the year 2000, and, according to Marcoccio, "the gap between the leaders and laggards...is widening." More than thirty countries have not begun to address the issue; 93 percent of computer companies and governments have not determined when their systems will fail; and 81 percent of all commercial software is not Y2K compliant. On a more positive note, awareness of the potential problems has increased, as has spending to tackle them.

John Koskinen, chair of U.S. President Clinton's Council on Year 2000 Conversion (left), and IMF First Deputy Managing Director Stanley Fischer

Although the United States is a leader in Y2K preparedness, it is unlikely to fix 100 percent of its systems before January 1. However, the experts generally agreed that the U.S. economy would do "relatively well." No national catastrophes are expected, although Koskinen noted that localized failures were quite possible. The federal government is taking steps to ensure that its systems work and that its interfaces with state and local governments work.

The United States is also working with the United Nations to bring other countries into the informational loop and encourage them to take action, Koskinen noted. Although the level of awareness of Y2K has grown, many countries are not sure how they will be affected and are taking a "wait and see" approach, which the speakers called a high-risk strategy. Although fixing the Y2K glitches in computers will be technically easy, Koskinen observed, everyone will be requiring the same fixes at the same time. Yardeni agreed with Koskinen's assessment, likening the Y2K phenomenon to a plumbing problem. "Everyone has the same problem and calls the plumber at the same time. Backups will occur."

Y2K is a management problem, not an information technology problem.

Describing the situation in the rest of the world, the experts indicated that some countries with immediate economic difficulties have, for obvious reasons, focused on those problems rather than on Y2K. Other countries that do not rely heavily on large mainframe computer sys-

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tems initially ignored the specter of Y2K. However, even in less technologically advanced countries, some mission-critical systems are partially automated and are thus vulnerable to Y2K problems—such as power outages, port delays, or supply shortages—which could wreak havoc on an economy. Koskinen singled out international shipping as a particularly vulnerable sector, whose Y2K-related problems could have a widespread impact.

(left to right) Lou Marcoccio, Tim Shepheard-Walwyn, and Edward Yardeni assess the macroeconomic implications of Y2K.

What can countries do?

Time is short, and countries that are ill prepared for the millennium may think it easiest or most cost-effective to respond to Y2K problems as they arise. Not so, argued the speakers with one voice. Although they asserted that there was no quick fix, or "silver bullet," they emphasized that countries should begin immediately, no matter where they are in terms of preparedness, to tackle both remediation and contingencies. They must identify their mission-critical systems, fix those they have time to fix, and develop plans to work around those they will not have time to fix.

The areas that are most likely to be affected and where efforts should be concentrated, according to the four experts, are electrical power systems, telecommunications, transportation, manufacturing, retail and wholesale distribution, government services and administration (including taxation), military defense, and international trade. The experts generally considered banking and financial systems, both national and international, to be in good shape.

For most countries, organization and resources are the biggest problem. Efforts to address Y2K problems should be coordinated, Koskinen said, as they are for natural disasters. In this connection, he noted that the United Nations, with World Bank support, has established the International Y2K Cooperation Center to share information around the world and promote increased cooperation and action among countries and industries on the Y2K problem to minimize its potential effects on the global economy and society.

What can the IMF do?

IMF staff members attending the seminar were particularly interested in learning what they could do to help member countries deal with the millennium bug. The answer was "plenty." Describing Y2K as a classic "prisoner's dilemma" because of the lack of information about what countries are doing to prepare for it and because of the uncertainty surrounding it, Shepheard-Walwyn offered compelling arguments for IMF involvement. He urged the IMF—with its access to the highest levels of government and ability to influence policy decisions—to encourage countries to set up a structure for dealing with the issue, appoint a high-level Y2K coordinator, and collect information on Y2K readiness. By making information available, Shepheard-Walwyn said, countries can help people assess risks and dispel uncertainties, which would go a long way toward averting the panic that could contribute to a global recession.

Specifically, the IMF should encourage central banks to formulate plans to instill confidence in the public. In anticipation of 2000, people may worry about credit, which could result in a "flight to quality" (when investors move their assets to safer havens), Shepheard-Walwyn said. Y2K is a systemic problem, and, according to Shepheard-Walwyn, it must be addressed collectively and cooperatively.

U.S. State Department official John O'Keefe, who joined the keynote speakers for region-specific discussions in the afternoon, suggested that the IMF had limited time and resources to help countries prepare for the millennium. For this reason, he said, it should give priority to the situations of high-impact countries with the strongest links to the international financial system. Yardeni argued for a proactive IMF role. In his view, the IMF should require countries to do more to show Y2K readiness as a condition for IMF assistance. He also proposed that IMF-supported programs earmark some of the resources for Y2K problems.

Conclusion

In his comments, Fischer noted that the IMF had reached a critical stage in its Y2K efforts, characterized by a shift in emphasis. Having collected information and alerted its member countries to the potential risks of Y2K—including the possibility that many of them would experience some inconveniences, disruptions, and breakdowns in the supply of goods and services—the IMF must now, Fischer said, begin to encourage countries to think about contingency plans to maintain critical functions. Thus, the IMF must be knowledgeable about outside sources of assistance, so that when members come to the IMF for help, they can be directed to possible solutions.

Or, in Yardeni's words, "prepare for the worst, hope for the best." ■

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IMFSURVEY

Recapitalization of banks helps ease credit crunch in Japan

Both fiscal and monetary policy initiatives during the 1990s have failed to revitalize the Japanese economy, which has been suffering its longest and deepest recession in the postwar period. Has a pervasive shortage of bank capital blocked the usual credit channels through which looser monetary policy can stimulate real economic growth? David Woo of the IMF's Monetary and Exchange Affairs Department examines this question in his study, *In Search of "Capital Crunch": Supply Factors Behind the Credit Slowdown in Japan*.

It is widely agreed, according to the author, that standard macroeconomic policies have failed to lift the Japanese economy out of the slump it has been experiencing throughout the 1990s. Fiscal stimulus introduced in 1995 created a brief spell of growth, but by 1997 this had dissipated. Monetary policy likewise appears to have had little impact despite near-zero nominal short-term interest rates. Ineffectual fiscal and monetary policies have led some observers to conclude that Japan's slump is less cyclical than structural, manifested in a financially distressed banking system, an aging population, labor market rigidity, and overregulation of the service sector.

Recently, the author observes, the view has received widespread support that problems in the banking system are chiefly responsible for Japan's malaise. Proponents of this view argue that a deterioration of loan quality and a loss in value of banks' securities holdings (the result of the decline in the Japanese stock market) have eroded the capital position of Japanese banks. Responding to the erosion of their capital base and reacting to closer scrutiny by regulators, banks have reduced lending in order to meet capital adequacy requirements. The contraction in bank lending has pushed marginal borrowers into bankruptcy, increasing the stock of nonperforming loans and putting further pressure on the banks' capital positions. Nor has the situation been improved by the sharp increase in the default rate of loans extended by Japanese banks to Southeast Asian countries. This scenario is called the "credit-crunch" theory of Japan's economic crisis. The proponents of this theory conclude that the banks have constricted the channels they traditionally keep open for the diffusion of credit and so have neutralized the effects of easier monetary policy.

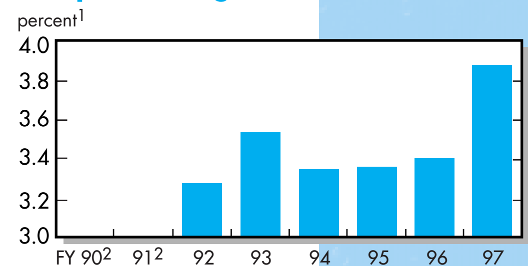
The credit-crunch theory gained additional support when the Japanese government announced a ¥60 trillion bank restructuring package in October 1998 and relaxed the regulatory framework by introducing accounting changes to raise the capital ratios of all banks. Meanwhile, to compensate for the lapse in bank credit, the Bank of Japan has been aggressively buying commercial paper on a repurchase basis and, in the process, has become a major indirect provider of lending to the nonfinancial sector.

The author tests the hypothesis that the shortage of bank capital has constrained the ability of Japanese banks to lend during the 1990s. With a sample of banks representing 90 percent of Japan's banking assets, he examines the dynamics between the evolution of bank balance sheet items and bank capital. He finds no evidence before 1995 to support the credit-crunch hypothesis. In fact, for most of the first half of the decade, it appears that weakly capitalized banks tended to increase their lending more rapidly than the more strongly capitalized banks. The author does, however, find strong support for the hypothesis in developments that took place in 1997. He argues that the uniqueness of 1997 was due in large part to a series of fundamental changes in the financial system, including the abatement of the moral hazard problem when the government allowed a string of failures of high-profile financial institutions to take place, as well as a substantial strengthening of the supervisory and regulatory framework and heightened scrutiny of the banks by the market.

Behavior of Japanese banks in the 1990s

The balance sheets of Japanese banks, considered the strongest in the world only a decade ago, deteriorated during the 1990s to an extent unparalleled in the postwar years. In the late 1980s, bank lending to property developers had risen sharply. The decline in land prices beginning in 1992 raised serious concerns over the quality of these loans, which had often been made under lax credit conditions and were mostly collateralized by what proved to be overpriced land. The volume of nonperforming loans rose (see chart). Despite substantial charge-offs and sales of bad loans, the share of nonperforming loans (defined as the sum of loans to bankrupt companies and loans at least six months overdue) over banks' total loans increased sharply in 1997. In response, banks significantly accelerated their loan-loss provisioning, thereby incurring substantial operating losses. These losses, together with the decision of most banks to continue paying dividends, further eroded the banks' capital base. Meanwhile, most banks were unable to raise new capital in the market.

Nonperforming loans



[1]Of total outstanding loans of major banks.
[2]Data not available.

Data : IMF Working paper 99/3, *In Search of "Capital Crunch": Supply Factors Behind the Credit Slowdown in Japan*

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In 1997, provisioning for nonperforming loans was subject to less rigorous supervision, leaving room for discretion to the banks themselves. The author suggests that weak banks, when faced with a capital shortage, tended to underprovision for their problem loans.

What happened in 1997?

For Japan's financial system, 1997 proved to be a benchmark year. A combination of factors prompted a change in the attitude of bank supervisors and in the market's perception of banks; in the wake of these developments, banks significantly altered their lending behavior. The developments underlying the change, in the author's view, were an increase in distress in the financial system, in regulatory pressure, and in market scrutiny.

Increased distress. A stream of bank closures and disclosures of distress in a number of high-profile financial institutions set a disruptive tone for 1997, focusing the attention of the market on the viability and integrity of the entire system.

- A merger planned between Hokkaido Takushoku Bank—one of the 20 largest Japanese banks—and Hokkaido Bank, announced in April, had to be postponed because of the bad debts of the former. Before the merger could be effected, Hokkaido Takushoku collapsed (November 17)—the first closure of a major bank in Japanese history.
- Nissan Mutual Life Insurance was ordered to suspend operations on account of insolvency. This closure raised questions about the viability of the whole insurance industry.
- Sanyo Securities decided to close, raising serious questions about the ability of weak institutions to honor their interbank obligations.
- Yamaichi Securities, burdened by large off-balance-sheet liabilities, suspended operations as the first step in closing its business.
- Tokuyo City Bank, experiencing heavy withdrawals of deposits and unable to raise funds in the market, collapsed.
- The Bank of Japan requested from Daiwa Securities and Nikko Securities a submission of concrete measures to restore financial soundness.
- To avert a systemic crisis by insuring the integrity of the payments system as well as the smooth repayment of deposits, the Bank of Japan extended emergency loans to several failed financial institutions, including Hokkaido Takushoku Bank and Yamaichi Securities, without requiring collateral.

These developments had a signal effect on the lending behavior of surviving banks, causing them to lend more conservatively. To the extent that the failure of financial institutions reflected a conscious decision by the government to allow them to fail, the moral hazard problem in the system substantially abated. Banks recognized that they would suffer the same fate as the closed banks if they did not quickly restore soundness. The perception that soundness is linked to bank capital ratios may be one reason why weakly capitalized banks started to cut back on their lending.

The perception that soundness is linked to bank capital ratios may be one reason why weakly capitalized banks started to cut back on their lending.

Regulatory pressure. Legislation passed in 1997 required banks to engage in a self-assessment process, making them responsible for valuing assets on a prudent and realistic basis, and specified the capital ratio thresholds under which regulators could order banks to take remedial action. In addition, an autonomous and independent Financial Supervisory Agency was established to allow supervisors to act more effectively.

Market scrutiny. Bank failures prompted a wave of deposit withdrawals from banks (despite deposit insurance guarantees) and inflows of funds into the Postal Saving Scheme, whose liabilities are guaranteed directly by the government. Few banks were spared the consequent dramatic fall in their stock prices, although market differentiation between strong and weak banks has been pronounced. Weakly capitalized banks were forced to increase their capital ratios quickly, presumably by cutting back on their lending, since they were less likely than stronger banks to be able to raise capital in the market.

Conclusion

Two explanations have emerged in recent years for the seeming ineffectualness of monetary policy in Japan. The first, the liquidity trap hypothesis, argues that real interest rates in Japan are too high and that the already near-zero nominal interest rates constrain the ability of the central bank to loosen monetary policy. The second, the credit-crunch hypothesis, suggests that the credit channels of monetary policy are blocked and that banks have not responded to the lower interest rate environment by lending more because of a shortage of bank capital. The author tests this hypothesis by analyzing the relationship between bank capital and bank lending growth. He shows that there is no evidence supporting the credit-crunch hypothesis during the early 1990s. Nevertheless, he finds strong evidence for this hypothesis beginning in 1997—a year that saw significant strengthening of the regulatory environment, an increased scrutiny of banks by the market, and an abatement of the moral hazard problem in the system. The author's findings can be seen as lending support to the bank recapitalization package the Japanese government introduced in October 1998 to the extent that it is designed to alleviate the credit crunch. ■

Copies of IMF Working Paper 99/3, *In Search of "Capital Crunch": Supply Factors Behind the Credit Slowdown in Japan*, by David Woo, are available for $7.00 each from IMF Publication Services.

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IMF SURVEY

Effective exchange rate data for euro area to be published in *International Financial Statistics*

As reported in the March 22 issue of the *IMF Survey* (page 81), the IMF's *International Financial Statistics* for April 1999 includes for the first time comprehensive statistics reflecting major changes in the statistical systems of the euro area that became effective on January 1, 1999. In addition to the measures mentioned in the March 22 *IMF Survey*, the April 1999 *International Financial Statistics* also publishes nominal and real effective exchange rates for the euro area.

The IMF maintains two systems of real effective exchange rate (REER) indices. One covers 21 industrial countries and is based on unit labor costs; the second covers almost all IMF member countries and is based on consumer prices. For the euro page in *International Financial Statistics*, IMF staff have accordingly generated real effective exchange rate estimates for the euro area based on both unit labor costs and the consumer price index.

The weights (see table, below) used for both euro area REER measures were derived from the trade weights currently used for the IMF's effective rate systems. For the consumer price index system, weights for 25 primary commodities are aggregated as one commodity to reduce the computational burden. *Synthetic euro* exchange rates for each system have been constructed for the period before the introduction of the euro using trade weights drawn from the associated weighting scheme (see table, above), euro area exchange rates, and the official rates used to determine the initial value of the euro. The same weights, official lock-in rates, and indices denominated in national currencies were used to estimate euro area unit labor costs and consumer price indices denominated in euros.

The REER calculations are based on the staff's own methodology and may differ from those published by national authorities and other organizations, as is the case for all other effective exchange rates in *International Financial Statistics*. IMF staff will continue to incorporate newly available euro-related information into its REER measures, which will, in turn, be disseminated in future issues of *International Financial Statistics*. ■

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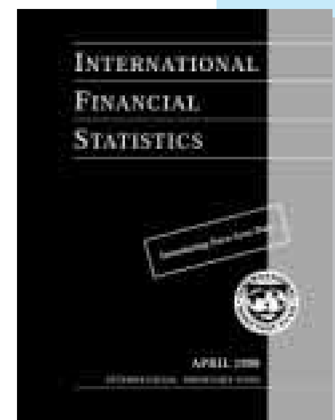

Weights used to calculate synthetic euro and euro area indices

	(A) ULC-based weights	(B) CPI-based weights	(A) – (B)
Austria	4.4072	4.9859	–0.5786
Belgium-Luxembourg	9.1905	10.7297	–1.5391
Finland	1.4503	1.4858	–0.0356
France	19.6628	18.2031	1.4597
Germany	33.2157	30.0458	3.1699
Ireland	1.0612	1.3603	–0.2991
Italy	14.8437	14.6564	0.1873
Netherlands	8.1578	9.8403	–1.6825
Portugal	1.2662	2.0376	–0.7714
Spain	6.7446	6.6552	0.0894
Total	100.0000	100.0000	0.0000

Note: ULC = unit labor costs; CPI = consumer price index.
Data: IMF staff

Effective exchange rate weights for the euro area
(percent)

	CPI weight	ULC weight
United States	21.8113	25.5827
United Kingdom	17.9232	30.3933
Japan	14.1473	14.4490
Switzerland	7.0452	12.6005
Sweden	5.1620	7.7661
Canada	4.3878	1.9980
Denmark	2.9669	3.3132
Korea	2.7616	...
Taiwan Province of China	2.7336	...
China	2.6064	...
Brazil	2.0663	...
Hong Kong SAR	2.0610	...
Australia	1.8519	0.4064
Singapore	1.6649	...
Norway	1.6260	2.0331
Turkey	1.4979	...
Greece	1.3683	1.3014
India	1.3281	...
Thailand	1.3136	...
South Africa	1.2524	...
Malaysia	1.2285	...
Mexico	1.1957	...
New Zealand	0.0000	0.1564
Total	100.0000	100.0000

Note: CPI = consumer price index; ULC = unit labor costs.
Data: IMF staff

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Press releases

Following are excerpts of recent IMF press releases. Full texts are available on the IMF's website (http://www.imf.org) under "news" or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

Honduras: ESAF

The IMF has approved a three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) for Honduras in an amount equivalent to SDR 156.8 million (about $215 million) to support the government's economic program for 1999–2001. The first annual loan, equivalent to SDR 76 million (about $104 million), will be available in two semiannual installments, the first of which, equivalent to SDR 59.9 million (about $82 million), will be available on April 12, 1999.

Honduras: selected economic indicators

	1995	1996	1997	1998[1]	1999[2]
	(annual percent change)				
GDP at constant prices	4.2	3.7	5.1	3.0	–3.0
Consumer prices (period average)	29.5	23.8	20.2	13.7	13.6
	(percent of GDP)				
Central government overall balance	–2.8	–4.1	–3.2	–3.2	–8.6
External public debt inclusive of IMF credit	101.2	94.8	78.8	71.6	80.2
	(months of imports)				
Gross international reserves	1.9	1.6	2.7	3.3	3.4

[1]Preliminary.
[2]Program.

Data: Honduran Central Bank and Ministry of Finance; and IMF staff estimates

Medium-term strategy and 1999 program

The main objectives of the authorities' economic program are to achieve a rapid, sustained recovery and address the considerable social needs, which have become more pressing as a result of Hurricane Mitch. The main targets are a recovery in the rate of real GDP to about 5–6 percent a year by 2000–01 following an expected decline in real GDP by 2–3 percent in 1999, mainly reflecting the extensive damage to the agricultural sector, a reduction in the 12-month inflation rate to 13–14 percent by December 1999 and to 8 percent by end-2001, and the maintenance of an international reserve position equivalent to 3–4 months of imports.

The government is preparing a revised budget for 1999 aimed at shifting spending priorities toward emergency relief and reconstruction, containing the growth in nonemergency expenditures, and strengthening revenue through improvements in tax administration. However, in view of the large size of the emergency relief and reconstruction needs, the program contemplates a marked widening of the combined public sector deficit in 1999 to about 8½ percent of GDP that is expected to be financed almost entirely by concessional loans and debt relief.

Prior to the hurricane, indications were that the Honduran external debt indicators did not reach the thresholds required for eligibility under the Heavily Indebted Poor Countries (HIPC) Initiative. In the wake of the hurricane, the staffs of the IMF, World Bank, and Inter-American Development Bank have begun work on a comprehensive reassessment of the country's debt situation and prospects for debt relief in the context of the initiative.

Structural reforms

The authorities have maintained their commitment to reforms aimed at stimulating private investment and economic growth, increasing public sector savings to meet the significant social needs over the medium term, and strengthening the financial system.

In the financial sector, the government has started to identify and address weaknesses in the legal and institutional framework for bank supervision. Also, over the period of the ESAF arrangement, the authorities will take steps to implement the recommendations of the banking commission resulting from the ongoing on-site inspection of banks.

Addressing social needs

The government's social sector policies focus on tackling poverty through faster economic growth and on improving the delivery and targeting of basic health, education, and social safety net services, with priority given to disease prevention, neonatal and child care, and minimum nutritional support.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
April 5	3.34	3.34	3.57
April 12	3.29	3.29	3.52
April 19	3.20	3.20	3.42

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (as of January 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 107 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer's Department

Members' use of IMF credit
(million SDRs)

	Mar. 1999	Jan.– Mar. 1999	Jan.– Mar. 1998
General Resources Account	**554.11**	**1,062.13**	**3,827.69**
Stand-By Arrangements	95.01	95.98	3,236.27
SRF	0.00	0.00	3,000.00
EFF Arrangements	459.10	557.13	591.42
CCFF	0.00	409.02	0.00
ESAF Arrangements	**49.79**	**207.64**	**188.21**
Total	**603.90**	**1,269.77**	**4,015.90**

Note: SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CCFF = Compensatory and Contingency Financing Facility
ESAF = Enhanced Structural Adjustment Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

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Uruguay: selected economic indicators

	Average 1985–94	1995	1996	1997	1998 Program	1998 Preliminary	1999[1]
	(percent change)						
Real GDP	3.6	–1.8	5.3	5.1	3.0	4.5	–1.0
Consumer prices (end of period)	72.9	35.4	24.3	15.2	7–9	8.6	4–6
	(percent of GDP)						
Overall government balance	–1.1	–1.7	–1.8	–1.4	–1.1	–1.0	–1.8
Current account balance	–0.7	–1.2	–1.2	–1.5	–1.6	–2.0	–2.0
	(months of imports of goods and services)						
Gross official reserves	7.4	5.9	5.8	5.9	5.8	6.6	6.4

[1]Program.

Data: Uruguayan authorities and IMF staff estimates

Honduras is an original member of the IMF; its quota is SDR 129.5 million (about $177 million), and its outstanding use of IMF credit currently totals SDR 78.7 million (about $108 million).

Press Release No. 99/11, March 26

Uruguay: Stand-By

The IMF approved a 12-month stand-by credit for Uruguay equivalent to SDR 70 million (about $95 million) to support the government's 1999 economic program. The government of Uruguay does not intend to make drawings under the stand-by credit and will treat it as precautionary.

Program for 1999

The 1999 program aims to bring 12-month inflation down to 4–6 percent by year's end and envisages a 1 percent contraction in real GDP, assuming negative output growth in Brazil and a significant slowing of growth in Argentina. The consolidated public sector deficit is programmed to increase to 1¾ percent of GDP, mainly reflecting the impact of the economic downturn on revenue and a charge of ¼ of 1 percent of GDP in onetime expenditures related to the administration of the general elections in October 1999.

Given the adjustable-band exchange rate regime and the freedom of capital flows, monetary policy is largely subordinated to exchange rate policy. Currency in circulation is projected to increase by 4 percent in 1999, slightly less than nominal GDP growth. Net international reserves are expected to decline by $200 million from their level at the end of 1998, reflecting the drawing down during 1999 of some prefinancing that was obtained in late 1998.

Structural reforms

The authorities do not anticipate launching major new structural reform initiatives in 1999, but instead will aim to consolidate programs already under way. These include a broadening of the list of instruments that private pension funds can invest in; a reduction in armed forces personnel; and working with congress to pass new bankruptcy legislation and a law on factoring, discounting, and establishing a market for receivables. In the banking sector, the government-owned Bank of the Republic will extend its contract with a private consultant to continue reforms and improve its efficiency and profitability.

Uruguay joined the IMF on March 11, 1946. Its quota is SDR 225.3 million (about $307 million), and its outstanding use of IMF credit currently totals SDR 114 million (about $155 million).

Press Release No. 99/12, March 29

Jordan: EFF and CCFF

The IMF has approved credits totaling SDR 162 million (about $220 million) for Jordan in support of the nation's economic adjustment and structural reform program for the period 1999–2001 and to help offset the impact of a temporary shortfall in exports of goods and services. Of the total, SDR 127.9 million (about $174 million) is available under a three-year Extended Fund Facility (EFF) credit and SDR 34.1 million (about $46 million) is being provided under the IMF's Compensatory and Contingency Financing Facility (CCFF). Jordan will have immediate access to credits amounting to SDR 44.8 million (about $61 million), including the amount of SDR 34.1 million from the CCFF.

Medium-term strategy and 1999 program

The three-year EFF-supported program is designed to promote a gradual recovery in the growth rate of real GDP to 3–4 percent, the maintenance of Jordan's low inflation rate, and a substantial strengthening in official foreign exchange reserves. These medium-term macroeconomic objectives will be pursued through fiscal consolidation, a continued prudent monetary policy consistent with the stability of the dinar, and wide-ranging structural reforms. The overall fiscal deficit will be reduced to 4.0 percent of GDP (1.4 percent of GDP after grants) by 2001, which will lead to a significant reduction in the ratio of public debt to GDP. The structural reform agenda emphasizes the areas of taxes, social security, financial sector, trade, and public enterprise reform and privatization.

The 1999 program aims to stabilize the Jordanian economy and set the stage for sustained recovery over the next two years. A modest improvement in the growth rate is targeted, while inflation is to remain low, and official foreign exchange reserves would begin a steady recovery. The overall fiscal deficit will be reduced to 7.9 percent of GDP. Monetary policy would

Jordan: selected economic indicators

	1996	1997	1998	1999	2000	2001
	(annual percent changes)					
Real GDP at market prices	1.0	1.3	2.2	2.0	2.5	3.5
Consumer price index (annual average)	6.5	3.0	4.5	1.9	2.8	2.4
	(percent of GDP)					
Overall fiscal balance (excluding grants)	–7.6	–7.2	–10.3	–7.9	–5.5	–4.0
Current account balance (excluding grants)	–9.5	–5.5	–4.8	–5.5	–5.4	–5.3

[1]Estimates.
[2]Program.
[3]Projections.

Data: Jordanian authorities and IMF staff estimates and projections

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seek to support the current exchange rate peg and help bolster international reserves. The external current account deficit is projected to rise slightly in 1999, mainly reflecting some increase in imports linked to the recovery in real GDP growth.

Structural reforms

During 1999, the authorities will intensify implementation of the structural reform agenda. In the fiscal area, income tax reforms will be introduced, and preparations will be made for the adoption of a value-added tax. In the financial sector, a new banking law will enhance bank regulation and supervision, and a deposit insurance scheme will be put in place.

Press Release No. 99/13, April 16

Adjustment measures under ESAF-supported programs are expected to strengthen a country's balance of payments position and foster growth.

Stand-By, EFF, and ESAF Arrangements as of March 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By Arrangements			**32,779.62**	**12,559.78**
Bosnia and Herzegovina	May 29, 1998	May 28, 1999	60.60	36.36
Brazil[1]	December 2, 1998	December 1, 2001	13,024.80	9,605.79
Cape Verde	February 20, 1998	April 19, 1999	2.10	2.10
El Salvador	September 23, 1998	February 22, 2000	37.68	37.68
Korea[1]	December 4, 1997	December 3, 2000	15,500.00	1,450.00
Latvia	October 10, 1997	April 9, 1999	33.00	33.00
Philippines	April 1, 1998	March 31, 2000	1,020.79	633.40
Thailand	August 20, 1997	June 19, 2000	2,900.00	600.00
Uruguay	March 28, 1999	March 28, 2000	70.00	70.00
Zimbabwe	June 1, 1998	June 30, 1999	130.65	91.45
EFF Arrangements			**11,273.15**	**7,202.39**
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	15.80
Bulgaria	September 25, 1998	September 24, 2001	627.62	470.72
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Indonesia	August 25, 1998	November 5, 2000	5,383.10	2,259.40
Kazakhstan	July 17, 1996	July 16, 1999	309.40	154.70
Moldova	May 20, 1996	May 19, 1999	135.00	72.50
Pakistan	October 20, 1997	October 19, 2000	454.92	379.09
Panama	December 10, 1997	December 9, 2000	120.00	80.00
Ukraine	September 4, 1998	September 3, 2001	1,645.55	1,288.90
Yemen	October 29, 1997	October 28, 2000	105.90	76.90
ESAF Arrangements			**4,384.99**	**2,403.60**
Albania	May 13, 1998	May 12, 2001	35.30	23.53
Armenia	February 14, 1996	September 14, 1999	109.35	20.93
Azerbaijan	December 20, 1996	January 24, 2000	93.60	17.55
Benin	August 28, 1996	August 27, 1999	27.18	14.50
Bolivia	September 18, 1998	September 17, 2001	100.96	84.13
Burkina Faso	June 14, 1996	September 13, 1999	39.78	6.63
Cameroon	August 20, 1997	August 19, 2000	162.12	81.06
Central African Republic	July 20, 1998	July 19, 2001	49.44	41.20
Chad	September 1, 1995	April 30, 1999	49.56	0.00
Congo, Republic of	June 28, 1996	June 27, 1999	69.48	55.58
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	161.98
Ethiopia	October 11, 1996	October 22, 1999	88.47	58.98
The Gambia	June 29, 1998	June 28, 2001	20.61	17.18
Georgia	February 28, 1996	July 26, 1999	166.50	27.75
Ghana	June 30, 1995	June 29, 1999	164.40	27.40
Guinea	January 13, 1997	January 12, 2000	70.80	23.60
Guyana	July 15, 1998	July 14, 2001	53.76	44.80
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Honduras	March 26, 1999	March 25, 2002	156.75	156.75
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	43.00
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	27.28
Madagascar	November 27, 1996	November 26, 1999	81.36	54.24
Malawi	October 18, 1995	December 16, 1999	50.96	7.64
Mali	April 10, 1996	August 5, 1999	62.01	0.00
Mongolia	July 30, 1997	July 29, 2000	33.39	27.83
Mozambique	June 21, 1996	August 24, 1999	75.60	12.60
Nicaragua	March 18, 1998	March 17, 2001	148.96	67.27
Niger	June 12, 1996	August 30, 1999	57.96	9.66
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	47.60
Senegal	April 20, 1998	April 19, 2001	107.01	71.34
Tajikistan	June 24, 1998	June 23, 2001	100.30	60.00
Tanzania	November 8, 1996	November 7, 1999	181.59	29.38
Uganda	November 10, 1997	November 9, 2000	100.43	43.52
Yemen	October 29, 1997	October 28, 2000	264.75	176.75
Zambia	March 25, 1999	March 24, 2002	254.45	244.45
Total			**48,437.76**	**22,165.80**

[1]Includes amounts under Supplemental Reserve Facility.
EFF = Extended Fund Facility
ESAF = Enhanced Structural Adjustment Facility
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

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Fundamentals, timely policy measures help Singapore weather Asian crisis

As a small open economy, Singapore is more vulnerable than most countries to external economic developments. Thus, the large and adverse economic shocks triggered by the Asian crisis could have been expected to generate significant economic problems for the country. Amid extensive economic distress in the region, however, Singapore has maintained a relatively favorable economic performance. Its economy recorded positive growth for 1998 and lately has shown signs of recovery. Singapore's resilience appears to be rooted in strong fundamentals and a willingness to take timely and effective policy measures in response to the crisis.

Impact of crisis

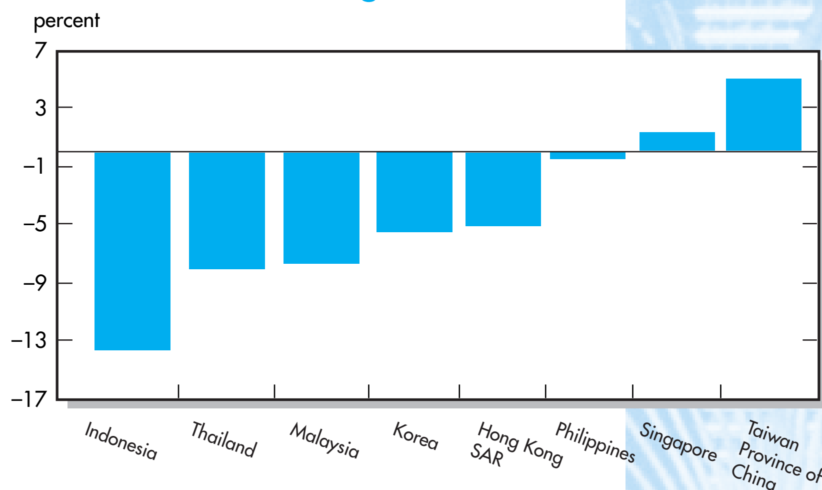
With its strong regional links, Singapore inevitably saw its economic performance during the regional crisis adversely affected through several channels. Diminished demand and exchange rate depreciation lowered its exports to the rest of Asia, and the crisis reduced its banks' regional lending as well as activity in the stock market and foreign exchange market. The collapse of intraregional trade hampered growth in Singapore's commerce and transport sectors, while subdued consumer sentiment and a drying up of tourist arrivals contributed to weakness in the retail sector. In addition, regional spillovers and a worldwide weakening of electronics, which had begun before the Asian crisis, caused a contraction in manufacturing production in 1998. Mainly as a result of these developments, real GDP expansion slowed sharply from 8 percent in 1997 to 1½ percent in 1998—the lowest growth rate since 1985.

Still, in comparison with other economies in the region, Singapore's macroeconomic performance since the beginning of the crisis has been favorable. While low by Singapore's standards, growth in 1998 exceeded that of other countries in the region, except for Taiwan Province of China (see chart). Similarly, while asset prices in Singapore have dropped substantially, much of the fall in property prices took place before the crisis began, reflecting measures undertaken by the authorities to cool the market. In addition, the decline in stock prices has also been less severe than the regional norm. The already large current account surplus rose further, largely because of import compression but also due to a strong surplus in the income balance generated by a large stock of overseas assets. Although the capital and financial account deficit remained large during 1998—chiefly as a result of banking sector net outflows and some slowing of net direct investment inflows—Singapore maintained its reserves at about nine months of imports. More recently, signs of recovery have started to emerge, including a ½ of 1 percent increase in real GDP in the fourth quarter of 1998 on a seasonally adjusted basis and an upswing in industrial production early in 1999.

Roots of resilience

Fundamentals. Singapore's favorable performance reflects, first, strong fundamentals. The country's fiscal policy is guided mainly by medium-term considerations, and the budget typically has been in surplus (averaging 5 percent of GDP during fiscal years 1990–98) at moderate levels of expenditure and taxation. These surpluses have produced a substantial level of fiscal reserves. Monetary policy has been anchored by the exchange rate and directed at price stability, and has helped limit inflation to an average of about 2 percent during 1990–98. Generally flexible labor markets and policies have led to skill development and higher value-added activities; the trade regime is very open, and Singapore has a high degree of capital mobility. Finally, the banking system is well supervised and has a strong capital base.

East Asia: real GDP growth, 1998



Data : World Economic Outlook, 1999

Policy response. Just as important, the authorities' policy responses to the crisis have been flexible, timely, and pragmatic and have included a range of fiscal, monetary, structural, and financial sector initiatives:

- *Fiscal policy.* Fiscal policy has been eased substantially in response to the crisis. For 1998/99, the authorities sharply increased development spending and implemented a package of supplementary measures. Together, these initiatives brought the primary operating balance into a deficit of about ½ of 1 percent of

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Center of Singapore

GDP—the first deficit since the recession of the mid-1980s. The deficit for 1999/2000 is expected to widen to 3½ percent of GDP as a result of higher development spending and lower revenues. This fiscal stimulus would seem to be appropriate in the context of a sizable negative output gap, large fiscal reserves, and a credible fiscal policy founded on a strong track record.

• *Monetary policy.* Following the outbreak of the regional crisis in mid-1997, Singapore also took steps to ease its monetary policy. Interbank interest rates have declined sharply over the past year; banks have been gradually reducing both lending and deposit rates; and the exchange rate has fluctuated in a flat and wider band. Despite the easing of monetary conditions, inflation is mildly negative—reflecting slow growth in unit labor costs in a relatively slack labor market, and falling commodity and imported food prices.

• *Structural measures.* Singapore's policy response to the crisis also took the form of structural initiatives. The authorities implemented a package of measures designed to reduce business costs and improve competitiveness and thus alleviate the burden on firms from the cyclical downturn in export markets and the realignment of regional currencies. The package halved the employer contribution rate to the Central Provident Fund (a compulsory saving scheme mainly used to finance pensions), and introduced tax rebates and cuts in government charges. In addition, a consensus emerged for wage cuts of 5–8 percent in 1999. These measures are expected to encourage employment and hence reduce the burden of unemployment, while also helping to position firms to meet a rebound in export demand. For the long term, Singapore remains committed to shifting into higher value-added activities by upgrading human capital and physical infrastructure.

• *Financial sector.* In addition, Singapore is implementing important financial sector reforms. The financial and business service sector accounts for some 31 percent of Singapore's GDP, reflecting the country's long-standing policies to encourage its development. In recent years, however, financial sector growth has slowed, and the regional crisis has highlighted other outstanding issues, such as transparency and regulation. In response, the authorities have recently enhanced financial sector transparency by raising disclosure standards for banks and are emphasizing supervision of financial institutions rather than excessive regulation. The authorities also took the opportunity afforded by the present lull in regional activity to position the financial sector for the next wave of regional growth. To this end, they relaxed some restrictions governing the internationalization of the Singapore dollar and are in the process of enacting a variety of regulatory changes and incentives to expand the investment fund management industry and the bond market.

Lessons

Singapore's resilience in the face of the large and adverse economic shocks triggered by the Asian crisis may offer lessons for other countries. Singapore's long record of prudent macroeconomic policies and market-oriented structural reforms established strong economic fundamentals and enhanced the ability of the economy to absorb shocks. The financial reserves and strong track record built up by these policies also helped reassure markets that the measures taken by the authorities to address short-term problems are less likely to endanger or signal a deviation from commitments to long-term goals. In addition, Singapore responded to the Asian crisis with a set of timely, flexible, and well-aimed policy measures. Taken together, these measures helped cushion the adverse consequences of the crisis while positioning Singapore for the recovery. ■

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