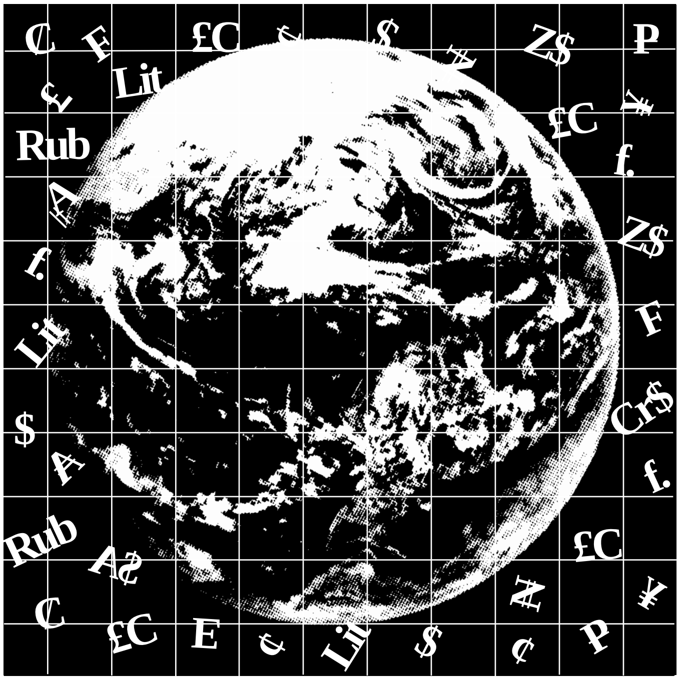
# Emerging Market Financing

## Quarterly Report on Developments and Prospects



**May 10, 2001**

**By a Staff Team led by Bankim Chadha**

INTERNATIONAL MONETARY FUND

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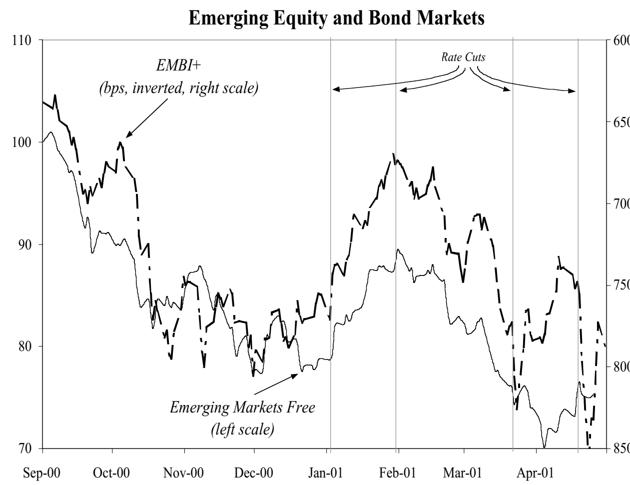
## I. Overview

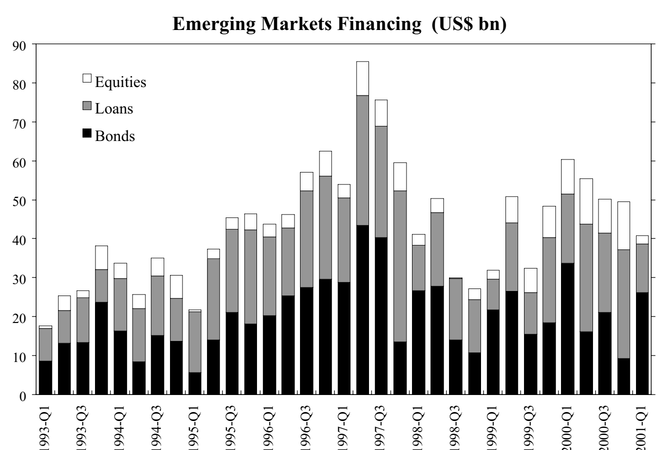
*As evidence of the global slowdown accumulated during the first quarter, emerging market assets and financing gyrated along with global markets on changing expectations about its depth and duration:*

- *In January, emerging bond and equity markets rallied on the surprise cut in US interest rates. Emerging market issuers were quick to exploit the window of opportunity provided, and many sovereigns successfully pre-funded much of their financing needs for 2001.*
- *In February and March, the rallies fizzled and January's gains were partly or completely reversed on continuing evidence of US economic slowing and poor corporate earnings reports while further rate cuts failed to surprise. Emerging markets' access to international debt markets dried up and investor concerns about emerging market fundamentals grew. Turkey was forced to float the lira, and investor concerns about fiscal and exchange rate sustainability in Argentina once again came to the fore.*




- *In April, emerging equity markets were buoyed by a recovery in global equity markets and another unanticipated US rate cut. Emerging debt markets meanwhile first rallied as investor concerns about Argentina ebbed, then fell back as concerns heightened again.*

*Emerging market fundamentals weakened over the quarter. Growth forecasts were revised down along with those in the mature markets, while average emerging market credit quality suffered its first notable setback since recovery from the Asian and Russian crises began. Spillovers to other emerging markets from Turkey and Argentina were, however, limited, and the increase in overall market volatility was relatively modest.*




*The near record spike in January bond issuance helped boost the quarterly volume of bond issuance to its highest level since the post-Y2K boom. Sharp drop offs in international equity placements and syndicated lending, however, depressed fund raising over the quarter well below average 2000 levels.*

*We analyze two facets of emerging market assets and financing that were potentially key to performance during the* *last quarter, and remain so for the outlook:*

- *The role of US interest rate cycles. The historical experience indicates that the path of US interest rates, in and of itself, has not been sufficient to determine the direction of emerging market spreads or emerging equity markets, and that, therefore, other factors matter as well.*
- *The "beta" of emerging equity markets in a global portfolio. With the broad direction of global equity markets at this juncture closely tied to expectations of the magnitude and length of global economic slowing, the reputation of emerging markets as "high beta" assets has rendered them particularly susceptible to—and leaves them particularly vulnerable to—changing expectations of the broad direction of global equity markets.*

*The outlook for emerging market assets and financing remains, as it has over the last year, closely tied to developments in the external environment. Last quarter's "soft" versus "hard" landing debate about the US economy, has given way to how "rough" the landing will be, whether it will entail a flight to quality, and when recovery will occur. As has been the case year-to-date, changing expectations about the outcomes of these questions are likely to keep markets volatile. Our baseline outlook for this year continues to see moderate bond financing flows, while the prospects for equity placements have diminished further. We expect the syndicated loan market to remain supportive though the downside risks have risen.*

| | | | | 2000 | | | | 2001 | 2001 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | 2000 | 1st qtr. | 2nd qtr. | 3rd qtr. | 4th qtr. | 1st qtr. | Jan. | Feb. | Mar. | Apr. 1/ | YTD 1/ |
| | | | | | | *(in billions of US dollars)* | | | | | | | |
| **ISSUANCE** | **149.0** | **163.6** | **216.4** | **60.4** | **55.4** | **50.3** | **50.2** | **41.2** | **12.8** | **11.5** | **16.9** | **4.4** | **45.5** |
| Bonds | 79.5 | 82.4 | 80.5 | 33.8 | 16.1 | 21.1 | 9.4 | 26.2 | 11.0 | 8.4 | 6.8 | 3.5 | 29.7 |
| Equities | 9.4 | 23.2 | 41.7 | 8.9 | 11.6 | 8.8 | 12.4 | 2.2 | 0.3 | 1.6 | 0.3 | 0.0 | 2.2 |
| Loans | 60.0 | 58.1 | 94.2 | 17.6 | 27.7 | 20.4 | 28.5 | 12.8 | 1.5 | 1.4 | 9.8 | 0.8 | 13.6 |
| **ISSUANCE BY REGION** | **149.0** | **163.6** | **216.4** | **60.4** | **55.4** | **50.3** | **50.2** | **41.2** | **12.8** | **11.5** | **16.9** | **4.4** | **45.5** |
| Asia | 34.2 | 56.0 | 85.9 | 19.5 | 26.1 | 18.3 | 22.0 | 18.5 | 3.7 | 5.5 | 9.4 | 0.6 | 19.2 |
| Western Hemisphere | 65.7 | 61.4 | 69.1 | 23.7 | 13.9 | 18.8 | 12.7 | 15.0 | 7.1 | 4.0 | 3.9 | 1.8 | 16.8 |
| Europe, Middle East, Africa | 49.0 | 46.3 | 61.4 | 17.1 | 15.4 | 13.2 | 15.5 | 7.6 | 2.0 | 2.0 | 3.7 | 2.0 | 9.6 |
| **SECONDARY MARKETS** | | | | | | | | | | | | | |
| **Bonds:** | | | | | | | | | | | | | |
| EMBI+ (spread in bps) 2/ | 1,037 | 703 | 756 | 674 | 712 | 677 | 756 | 784 | 674 | 748 | 784 | 787 | 787 |
| Merrill Lynch High Yield (spread in bps) | 555 | 453 | 871 | 584 | 615 | 664 | 871 | 757 | 739 | 729 | 757 | 740 | 740 |
| Salomon's Broad Investment Grade (spread in bps) | 58 | 55 | 89 | 81 | 87 | 83 | 95 | 89 | 79 | 84 | 89 | 80 | 80 |
| U.S. 10 yr. Treasury Yield (yield in %) | 4.7 | 6.3 | 5.1 | 6.0 | 6.0 | 5.8 | 5.1 | 4.9 | 5.2 | 4.9 | 4.9 | 5.3 | 5.3 |
| **Equity:** | | | | | | | *(in percent)* | | | | | | |
| DOW | 16.1 | 25.2 | -6.2 | -5.0 | -4.3 | 1.9 | 1.3 | -8.4 | 0.9 | -3.6 | -5.9 | 8.7 | -0.5 |
| NASDAQ | 39.6 | 85.6 | -39.3 | 12.4 | -13.3 | -7.4 | -32.7 | -25.5 | 12.2 | -22.4 | -14.5 | 15.0 | -14.3 |
| MSCI Emerging Market Free | -27.5 | 63.7 | -31.8 | 2.0 | -10.8 | -13.4 | -13.5 | -6.2 | 13.6 | -7.9 | -10.3 | 4.7 | -1.8 |
| Asia | -12.4 | 67.6 | -42.5 | 4.0 | -14.0 | -22.3 | -17.3 | -0.1 | 19.5 | -6.1 | -11.0 | 0.0 | -0.2 |
| Latin America | -38.0 | 55.5 | -18.4 | 3.2 | -8.1 | -6.0 | -8.5 | -3.5 | 13.8 | -9.0 | -6.8 | 5.7 | 2.0 |
| Europe/Middle East | -27.4 | 76.7 | -23.4 | 3.0 | -9.7 | -3.9 | -14.3 | -22.0 | 3.3 | -15.4 | -10.8 | 12.8 | -12.1 |

Sources: Bloomberg; and Capital Data Ltd.

1/ Issuance data are as of April 18, 2001 close-of-business London and Secondary markets data are as of April 30, 2001 cob New York.

2/ On April 14, 2000 the EMBI+ was adjusted for the London Club agreement for Russia. This resulted in a one-off (131) bps decline in average measured spreads.

## II. Recent Developments

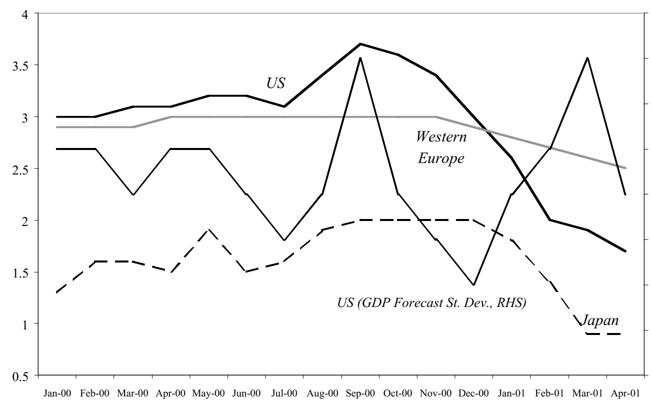
### A. The External Environment

The external environment **proved volatile** during the first quarter of 2001. While expectations of a **slowing in the major industrial economies increased sharply**, financial **markets gyrated** on **changing expectations about the extent and duration of the slowdown**. Meanwhile, the **TMT sector's prospects were downgraded further**.

Consensus **forecasts** for US **GDP growth**, which had begun to be revised down in the previous quarter, were **downgraded successively** further (see chart). The growth forecast for this year halved from 3.7% last September to 1.8% by March. The outlook for **growth in Japan was cut sharply** from 2.0% in December to 0.9% by March, while the downgrade of European growth was more modest. **Indicative of the uncertainty** about the magnitude and length of slowing, there was a **notable increase in the range of forecasts** with, for example, the standard deviation of GDP forecasts for the US rising sharply over the quarter from 0.2 in December to 0.7 by March (see chart). In April, even as growth forecasts were revised down further, there was a marked reduction in the range of forecasts, with the standard deviation declining from 0.7 to 0.4.

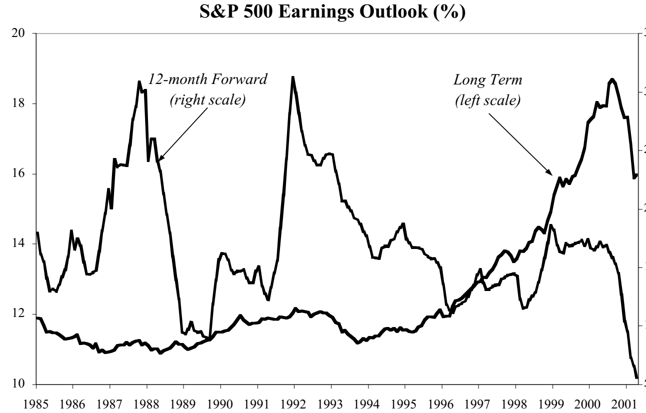
In US equity markets, the economic slowdown was manifest in **tumbling forecasts of corporate earnings**-per-share growth (12-month forward), down to 6% by March, from 16% last August, falling for the **first time below their 1989-90 recession lows** (see chart). Expectations of **"long run"** (5-year) **earnings growth**, having ratcheted up steadily on euphoria about the "new economy" phenomenon from 1995, experienced for the first time

**Evolution of Consensus 2001 GDP Growth Forecasts (yoy % change)**



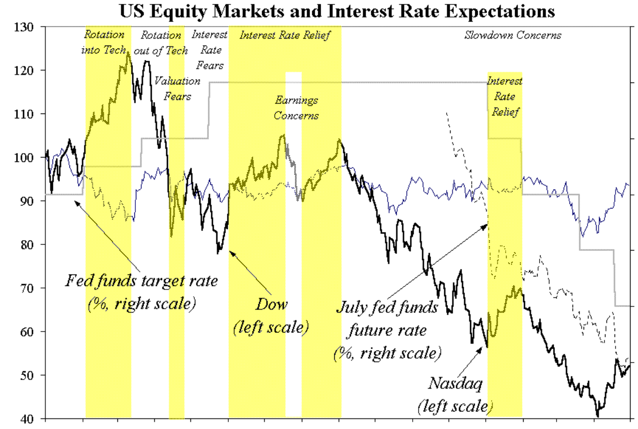

*Source: Consensus Economics*

**S&P 500 Earnings Outlook (%)**



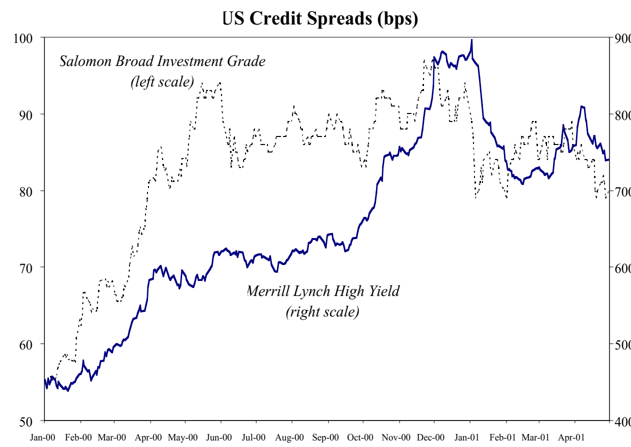

*Source: IBES International*

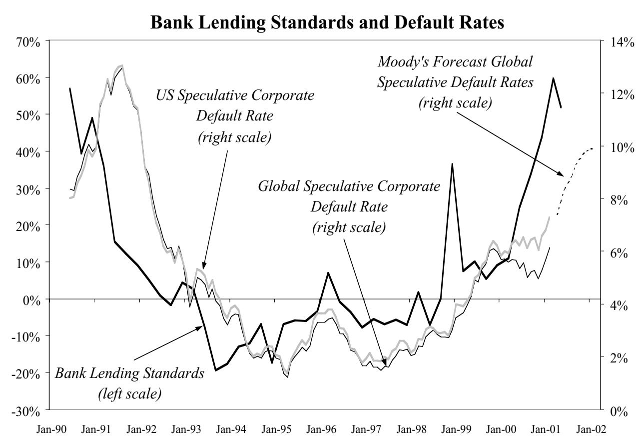
**US Equity Markets and Interest Rate Expectations**



since then, a second **consecutive quarter of downgrades**. These expectations still remain, though, well above 1985-95 average levels.

Against the backdrop of substantial uncertainty surrounding the extent and duration of economic slowing, **markets rallied** in January **on the unanticipated cut in US interest rates** as the impact of lower discount and borrowing rates was seen as mitigating the impact of slower earnings growth. The rally was **concentrated in higher risk assets** such as the Nasdaq (up 25%) and US high yield markets (spreads narrowed 170 bps), suggesting an increased tolerance for risk by investors on expectations of a softer landing in the US. The Dow rose slightly (3%), and high grade spreads tightened (-16 bps).




Sources: US Federal Reserve; Moody's.

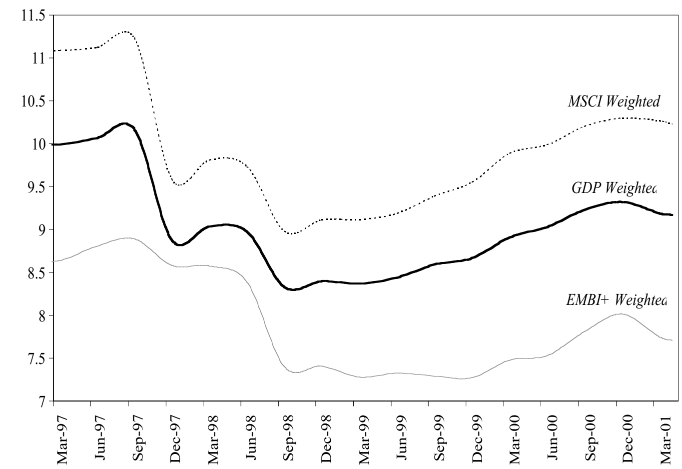
**US markets fell back** in February and March, as news of the economic slowing and earnings disappointments accumulated, and **subsequent US interest rate cuts failed to surprise**. The sell off was most pronounced in the Nasdaq, where a **structural and cyclical downgrading of the TMT sector combined to result in a 43% decline** from its February peak to its April low. Starting somewhat later, the Dow fell 15% during this period, while high grade (6 bps) and high yield (50 bps) spreads backed up. For the quarter as a whole, equity markets posted losses, giving up in February-March more than their January gains. By contrast, fixed income spreads widened less in February-March than they had narrowed in January. Combined with coupon yields and gains from declines in interest rates, fixed income markets turned in positive returns. Though credit spreads in the high grade and high yield bond markets narrowed over the quarter, US **bank lending standards tightened** further, reaching **levels not seen since the 1990-91 recession** on concerns about the slowing economy and forecast default rates (see chart).[1] In **April**, US **markets rallied again**, boosted by a second surprise intra-meeting cut in US interest rates.

[1]Bank Lending Standards reported here are the result of quarterly surveys (conducted by the US Federal Reserve) of senior loan officers of banks, reporting whether banks' lending standards for commerical and industrial loans to large- and medium-sized firms have tightened or eased over a three-month period. A measure of 0% represents an equal percentage of banks tightening and easing their standards over the period.

## B. Emerging Market Fundamentals

With **two major emerging markets**—Argentina and Turkey—plunging, for well-documented reasons, **into or near crisis**, the first quarter of 2001 witnessed the **first major setback** to the steady upswing in average emerging market credit quality **since recovery from the Russian crisis** began in late 1999 (see chart and table). Our indices of sovereign ratings **peaked in January** this year, following Russia's reclassification from "selective default" by S&P to a B- rating in the last quarter of 2000, and Brazil's upgrade in January this year. With the January **peak well below pre-Asian crisis levels**, and the ratings of several Asian sovereigns, Mexico, and South Africa having been on positive outlooks for several months, expectations at the time had been for further upgrades.

**Emerging Markets Credit Quality Indices**




Sources: Bloomberg, Reuters, IMF Staff estimate:

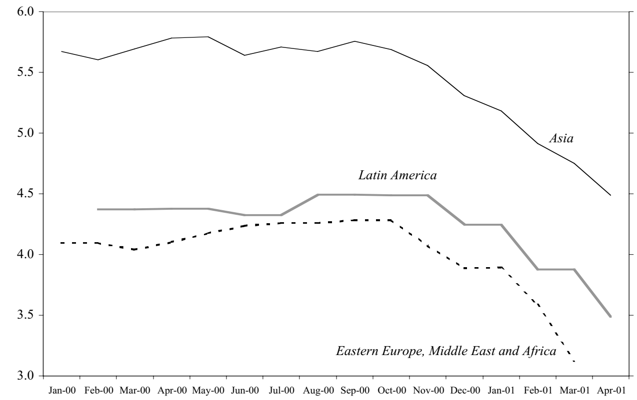
Financial and political concerns in **Turkey, Argentina, and Ecuador**, however, resulted instead in **downgrades**, while the **poor** and uncertain **external environment halted the upgrades momentum**. In February, the rating agencies cut **Turkey**'s sovereign and corporate ratings, citing concerns about the pressure the lira **devaluation** could bring to public finances and balance sheets of domestic banks. In March, **S&P cut the ratings of the Argentine sovereign** citing the "difficult policy environment, in which the government [was] struggling to calm political and market pressures" through a program that "strengthens competitiveness, reduces fiscal imbalances, and ultimately restores growth." In March, **Moody's** also downgraded the sovereign citing "heightened funding risks emanating from reduced prospects for a return to sustainable growth" in a deflationary environment, which is "having an effect on the country's ability to access new new sources of external finance." In April, **Ecuador's failure to increase the VAT** rate prompted S&P to downgrade the sovereign on the view it endangered the country's fiscal sustainability. Similarly, **Malaysia's** continued **capital account leakages** and a **deterioration of the fiscal accounts** prompted a downgrading of the sovereign's debt rating outlook to stable from positive.

| | Agency | Rating Action |
|---|---|---|
| **Brazil** | S&P 01/03 | B+ to BB- |
| **Turkey** | S&P 02/22 | B+ to B, Creditwatch: Negative |
| | S&P 04/16 | B to B-, Outlook: Negative |
| | Moody's 02/21 | B1 Outlook: Negative from Stable |
| **Argentina** | Moody's 03/28 | B1 to B2, On Review for Downgrade |
| | S&P 03/26 | BB- to B+, Creditwatch: Negative |
| **Ecuador** | S&P 04/02 | B- to CCC+, Outlook: Negative from Stable |
| **Malaysia** | S&P 04/05 | BBB, Outlook: Stable from Positive |

*Sources: Bloomberg, Reuters*

**Looking forward**, market expectations continue to be for **Mexico's debt ratings to be upgraded** by S&P to investment grade by the fall, conditional on the successful passage of fiscal reform through Congress. This would boost the average credit quality indices, though the debt-weighted index would continue to be constrained by the size of Argentina (23%) in benchmark indices. In **Asia**, **fiscal concerns** and **lack of progress on structural reform** against the backdrop of a poor external environment are seen as constraining further improvements of sovereigns and corporates previously poised for upgrades.

**Evolution of Consensus 2001 GDP Growth Forecasts (yoy % change)**



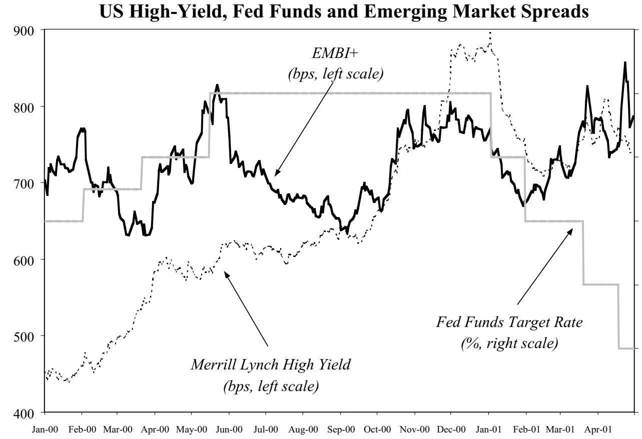

*Source: Consensus Economics, IMF Staff Calculations*

The **slowdown in the major industrial economies**, combined with country-specific factors, especially in Turkey and Argentina, took its **toll on growth outlooks for each of the major emerging market regions** (see chart).

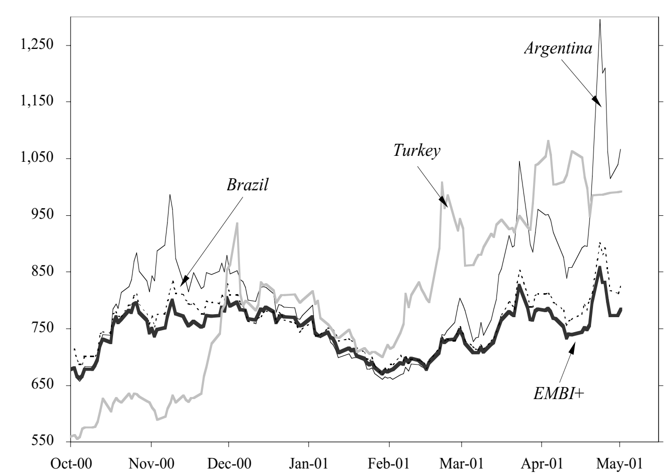
## C. Emerging Bond Markets

Emerging market **spreads rallied** along with those in the mature markets **following the unexpected Fed rate cut** on January 3, with the spread on the benchmark EMBI+ narrowing 100 bps over the month, to 670 bps (see chart). Argentina was the prime beneficiary. As the largest (incipient) emerging market borrower on international bond markets, and with its domestic interest rates tied closely to dollar rates through the currency board, its spreads narrowed 128 bps.

**US High-Yield, Fed Funds and Emerging Market Spreads**

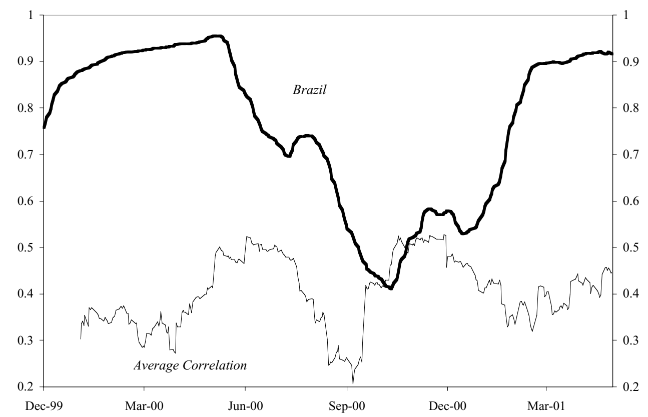



**Emerging Market Bond Spreads (bps)**

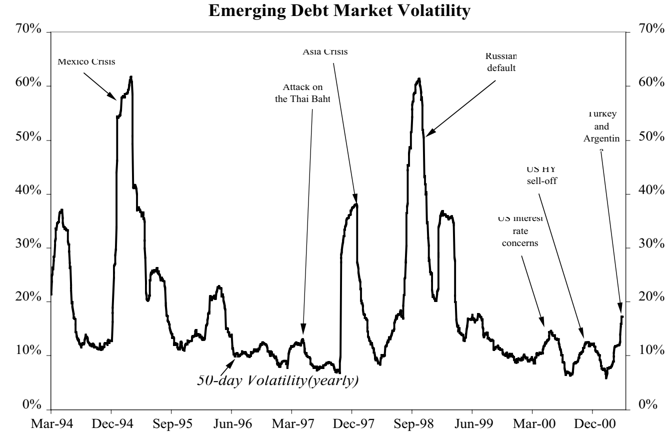



With the **subsequent Fed easing fully priced in**, the EMBI+ barely budged when the Fed actually cut rates on January 31. **Spreads began to widen soon thereafter** as the domestic political situations in both Argentina and Turkey deteriorated. The **devaluation in Turkey** (February 22) had only a **limited impact** on the overall EMBI+ spread, while the average cross-correlation of individual country returns in the emerging debt markets, a measure of "contagion" we discussed in detail last quarter, rose very modestly (see chart). This reflected Turkey's limited weight (2%) in the index, and that investors did not question the sovereign's ability to continue to service its foreign currency debt.

Average Emerging Debt Markets' Cross-Correlation and Brazil's Correlation with Argentina




**Emerging Debt Market Volatility**




In late March, **Argentina suffered a sharp sell off** as investors questioned the sustainability of the country's fiscal situation and its exchange rate regime. Despite, the sovereign's substantial share (23%) of the EMBI+, **spillovers**, **with the exception of Brazil, were limited**. The average cross-correlation of returns across emerging debt markets rose again, but remained low compared to previous episodes, and far below the 0.8-0.9 levels seen during the Asian and Russian crises. The **correlation of Brazilian and Argentine spreads remained high**.

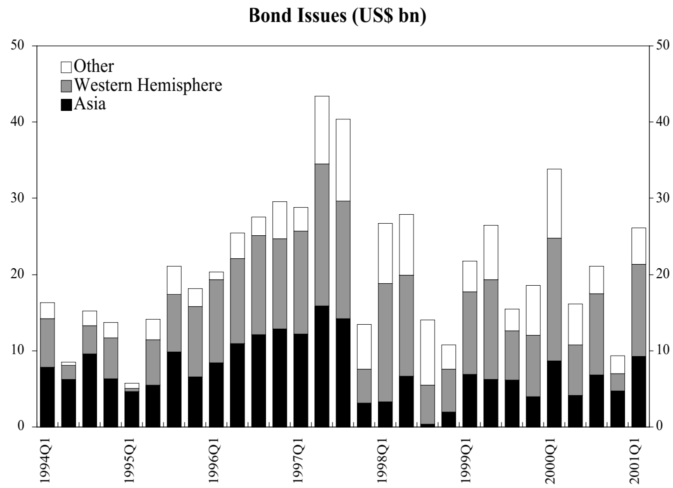
Emerging market **spreads closed the quarter only 28 bps wider**, showing relative **resilience to the turbulence**. In April, the EMBI+ spread fluctuated with concerns about Argentina, first narrowing, then widening by the last week of April to their highest level (857 bps) since November 1999. The **volatility** of returns on emerging market debt rose during the quarter but, relative to other historic episodes of emerging market stress, the increase was **modest** (see chart).

**Relative Performance of Emerging Market Debt**
(Total return in %)

| | 2000 | Q4 | Q1 |
|---|---|---|---|
| EMBI+ | 15.7 | 1.7 | 2.0 |
| US Govt. Bonds (JP Morgan GBI) | 13.9 | 5.2 | 2.3 |
| US Investment Grade (Salomon's BIG) | 11.6 | 4.2 | 3.1 |
| US High Yield (MLHY) | -3.9 | -4.0 | 6.3 |

With spreads widening only modestly over the quarter, emerging market debt delivered a **healthy total return**. This reflected, though, the fall in yields of underlying US Treasuries and coupon yields, which outweighed the capital losses from spread widening. Having been the best performing fixed-income (and otherwise) asset class in 2000, emerging market debt underperformed in the first quarter of this year, well behind US high yield, which had its long-awaited recovery from oversold conditions. Emerging market debt, however, continued to outperform most emerging equity markets.

**Primary markets** followed the tune of global markets, **booming in January**, with issuance reaching near record monthly levels as sovereigns rushed to exploit the window of opportunity provided by the Fed's rate cut and get a head start on their 2001 financing plans. Issuance then **tapered off**, as the external environment deteriorated, the Turkish lira was floated, and concerns about Argentina grew. For the quarter as a whole, emerging market issuance reached $26.2 bn, which compares favorably with the average quarterly issuance level of around $20 bn during 1998-2000.

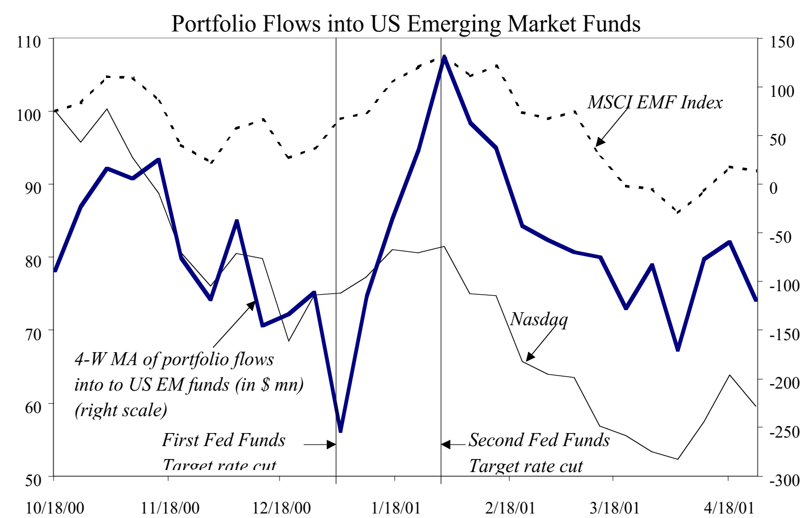



Latin America was again the largest issuer (46.1%). Mexico was the most successful, completing its external financing program for the year with a single $1.5 bn eurobond issue that attracted substantial crossover interest from the US high grade sector. Following the sovereign's successful issue, Mexican blue chips followed, with $1 bn dollar deals by both Telmex and Pemex. Asian issuance (35%) was dominated by Hong Kong SAR corporate Hutchinson Whampoa, which placed a $2.5 bn bond convertible into PCCW stock, and a $1.5 bn plain-vanilla eurobond. Both were part of the corporate's disinvestment strategy after having last year sold HK Cable and Wireless to PCCW. Given the backdrop of continued volatility in equity markets, convertible bond issuance has provided one avenue for beleaguered Telecom companies to raise new financing.

The head-start in January on  the year's financing allowed some sovereigns to again focus on **liability management operations.** Brazil and Mexico completed traditional Brady-eurobond exchanges, freeing up significant collateral and yielding NPV savings. In February, Argentina successfully completed a different kind of liability management operation (of $4.2 bn), which had as its primary focus reprofiling the near-term amortization payments for the sovereign, and was mainly targeted at domestic institutional investors.

## D. Emerging Equity Markets

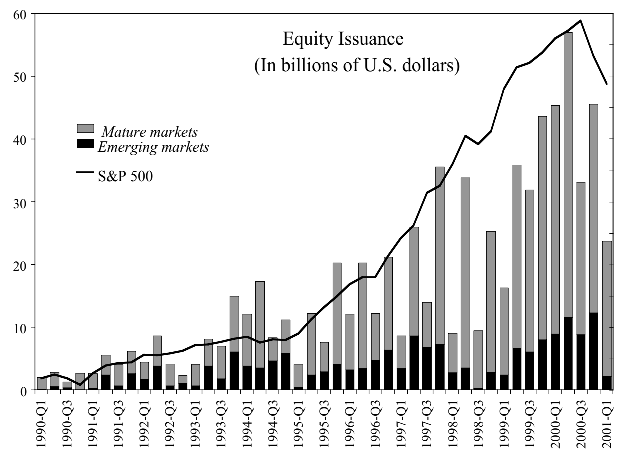
Emerging equity markets **broadly followed US equity markets** during the quarter. They **rallied strongly** following the **Fed's first rate cut on January** 3**,** with MSCI's benchmark Emerging Markets Free (EMF) index gaining 13.7% (see chart). Markets in Argentina, Korea, Taiwan Province of China and Thailand all rose by around 30%, whereas markets in China, Mexico, Russia and Turkey rose between



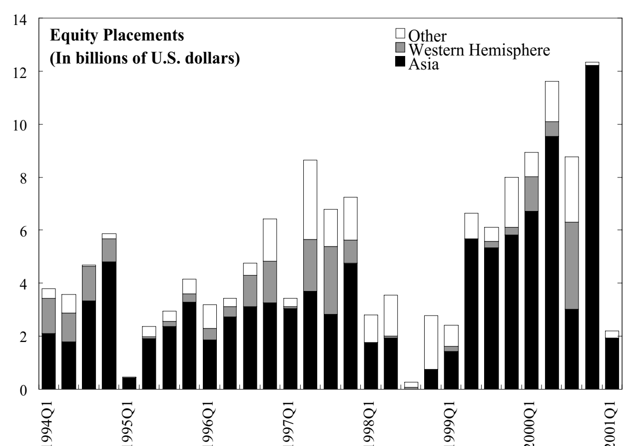

Sources: MSCI; AMG

15-20%. The **January rally was reversed in February and March**, with the **second fed funds target rate cut proving the inflection point**, and the EMF fell 17.4% over the two months (see chart). Notable during this period was the substantial decline in Turkey (-52%), both following, and as a result of, the depreciation of the lira. At the other end, despite the substantial decline of the Nasdaq during this period, the outperformance of the tech-heavy Taiwan Province of China (-8.7%), proving the best performing emerging market, reflecting expectations the new economic team would be able to restore confidence in economic management.

**Net flows** into US emerging market funds, having been significantly negative at the end of last year, **picked up after the Fed's first interest rate cut** on January 3, supporting the recovery in prices through the rest of the month (see chart above). **Flows reversed following the second Fed Funds Target rate cut** on January 31, suggesting a change in expectations about the extent and speed of the slowdown in the US was the key factor.

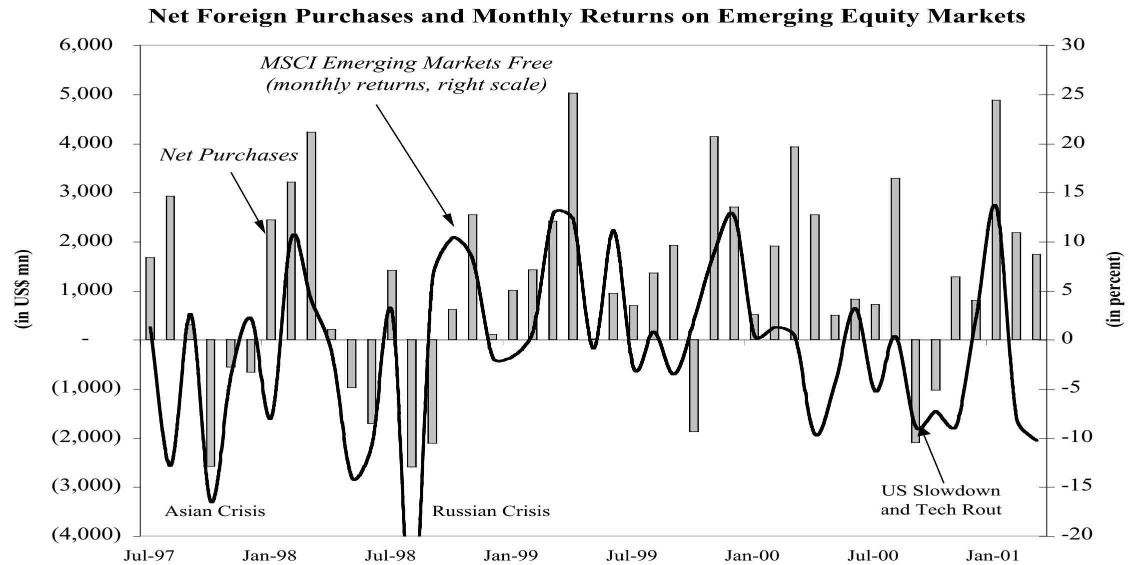



In primary markets, international **equity placements** by emerging markets **fell off sharply** in the first quarter to $2.2 bn, from $12.4 bn in the fourth quarter of 2000. The drought in emerging markets' international equity placements echoed the falloff in IPOs in the mature markets (see chart). **China**, responsible for half of emerging market issuance in what was a record-setting 2000, and up to 85% in the fourth quarter, **was again by far the largest issuer** ($1.5 bn). Supported by the high level of oil prices, the Chinese oil and gas company CNOOC ($1.3 bn) was the largest issuer. Russia's largest oil company Lukoil issued $200 mn, with the **oil sector accounting for the majority** (68%) of issuance.




### E. Foreign Investor Portfolio Flows to Emerging Markets

This quarter we **initiate coverage of foreign investor portfolio flows** to emerging equity markets using data from a number of stock exchanges (see Box 1 below). Rather than representing a comprehensive and complete measure, we view the data as **providing a relatively high frequency indicator of such flows**, as compared to balance of payments flows which, though more comprehensive, are available only with a substantial lag and at a




lower frequency. Since this is the first time we are reporting such flows, before discussing their behavior over the recent quarter, we make some observations about their longer-term behavior:

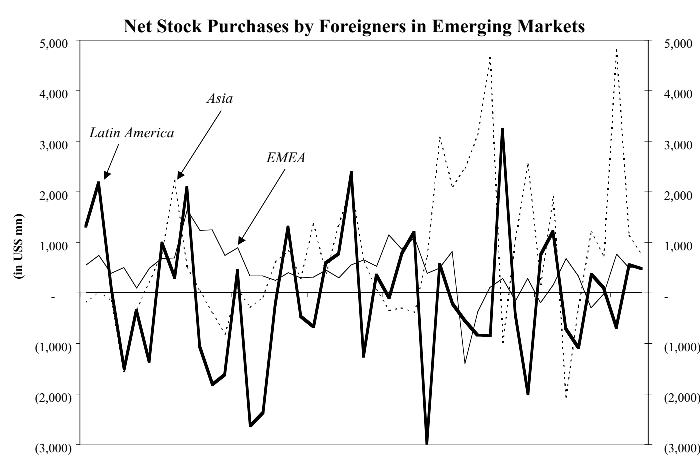
- The aggregate monthly data **conform with other evidence** about portfolio flows to emerging markets, showing **substantial foreign outflows** at the time of the **Asian crisis** in October-December 1997, and at the time of the **Russian crisis** in August 1998. More recently, there were **notable outflows during September and October 2000** as **concerns about the slowing of the US economy** gained momentum.

- There has been a **close association between foreign portfolio flows** to emerging equity markets and dollar **returns** in these markets (see chart). **Correlations** indicate **foreign investor flows potentially played a role** in impacting dollar returns, especially in Asian emerging markets (see table). On occasion the association has been stronger (see chart), indicating **instances when foreign investors have been particularly important** (price determining) **investors**, in both Asia and Latin America.

Correlation of foreign investor flows and monthly MSCI returns, July 1997—March 2000:

| | |
|---|---|
| EMF | 0.54 |
| Asia | 0.59 |
| Latin America | 0.22 |
| EMEA | 0.14 |

- Across regions, flows to **Asia and Latin America were closely correlated between July 1997 and mid-1999**. **Outflows from Latin America** then picked up and have been **sustained** since, consistent with the widely discussed structural shift reflecting the de-listing of many benchmark stocks, a move to trading



offshore (not captured here), and the absence of major TMT related investments in the region. **Flows to Asia**, the region with the biggest exposure to the TMT sector (around 55% at its peak last year) **peaked** in March 2000, **along with the Nasdaq**. Following the rout in the tech sector beginning in March 2000, foreign investors retrenched from Asia in April, but did so only briefly, with inflows resuming in June, as US interest rate concerns receded. In September-October 2000, **following growing US slowing concerns**, foreign investors **pulled out of both Asia and Latin America**, while flows to South Africa remained stable (Turkey experienced outflows for all months during 2000, with the exception of March).

**Box 1. Foreign Investor Purchases on Emerging Equity Markets: The Data**

The data are **net purchases by foreign residents**, as reported by emerging market stock exchanges that publish such data at a monthly (or higher) frequency. For Mexico, where only the stock of foreign holdings was available, flows were estimated by deflating the stocks. The data suggest the **most important emerging equity markets** for foreign investor flows, as measured by the average absolute flows to these markets have been **Mexico**, **Korea**, **South Africa**, and **Taiwan Province of China**.

We note several **caveats** to the data. First, they are not comprehensive across the emerging markets, though the **countries in the database cover 66% of the current market capitalization of the benchmark EMF index**. Second, for a variety of reasons the data will not always correspond to balance of payments flows. Third, foreign listings or placements of new issues, unless traded on local exchanges are not picked up in the database.

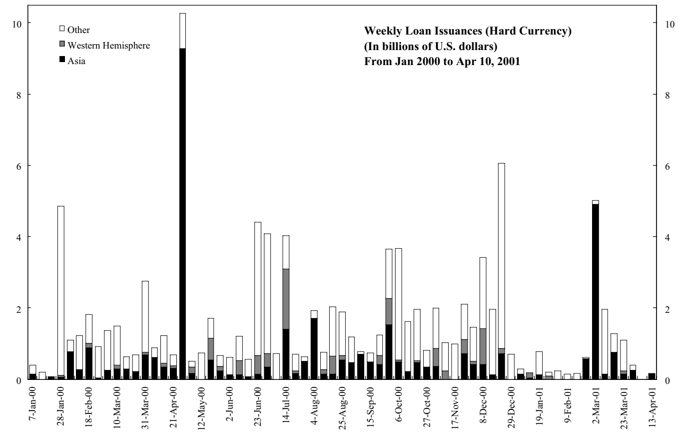
| July '97 – March '01 | Data Available | MSCI Weight (in %) | Average Flow | Average Absolute Flow |
|---|---|---|---|---|
| **Asia** | | | | |
| South Korea | Jul-97 | 10.0 | 337 | 700 |
| Taiwan Province of China | Jan-96 | 14.0 | 305 | 546 |
| India | Mar-97 | 6.1 | 112 | 199 |
| **EMEA** | | | | |
| South Africa | Jun-97 | 10.0 | 490 | 496 |
| Turkey | Jan-97 | 1.6 | 2 | 158 |
| **Latin America** | | | | |
| Mexico | Jan-94 | 11.3 | -41 | 855 |
| Brazil | Jan-93 | 10.1 | -63 | 378 |
| Chile | Jan-94 | 3.2 | 3 | 185 |

*Sources: Local Stock Exchanges and Central Banks.*

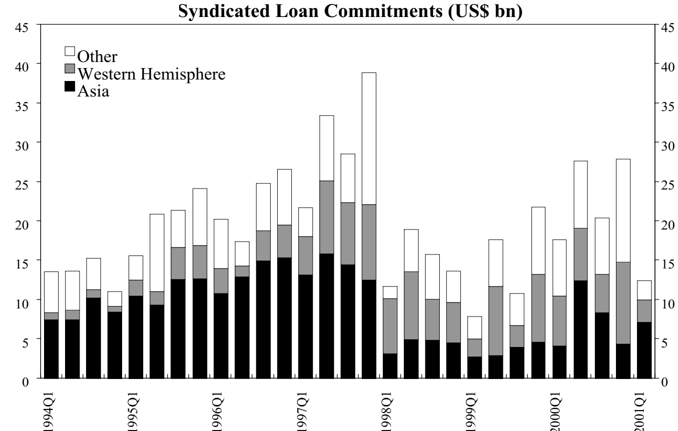
Turning to this quarter, **foreign investors rushed into Asia in January**, with **inflows reaching an all time high**. **Inflows to Asia then tapered off sharply** in February and March. **Latin America** as a whole **continued to suffer outflows** in January, but inflows into Mexico during February and March more than offset outflows from other countries. For the first quarter, Latin America accumulated outflows of $375 mn compared to inflows of $6.7 bn into Asia.

## F. Syndicated Lending

Syndicated lending to emerging markets **plummeted** in the first quarter of 2001. As was the case for US firms, emerging market corporates typically witnessed **higher premiums**, **increased fees**, **tighter loan covenants** and **strengthened collateral requirements**, reflecting a more **uncertain global economic outlook** and **industry-specific difficulties**. The overall volume of lending fell to $12.8 bn in the first quarter of 2001, down from $28.5 bn in the fourth quarter of last year. Loan volumes were particularly low in January and February, amid a flurry of activity in the bond markets. Syndicated lending picked up in early March, just as emerging market bond issuance fell off sharply.




Syndicated Loan Commitments (US$ bn)




Reflecting the refinancing of PCCW's $4.7 bn jumbo loan, the **composition** of syndicated lending to emerging markets **shifted in favor of Asia**, the recipient of around 60% of all loans. Elsewhere in Asia, the Philippine central bank completed a $740 mn self-arranged facility to refinance maturing obligations, increasing the deal from $400 mn on keen investor interest, while Korean commercial banks were active borrowers ($681 mn). Notably, **Argentine corporates** accounted for the largest share of borrowing in **Latin America** (one-third or $921 mn), with new issues bunched in early January following an improvement in sentiment and a number of refinancings occurring at the height of the uncertainty in March.

In terms of **sectoral composition, telecom-related lending** comprised the lion's share, with the quarter dominated by the refinancing of PCCW's $4.7 bn term loan. Under the shadow of some €90 bn in 364-day facilities for British Telecom, France Telecom, Vodaphone, Deutsche Telecom, Telefonica, Telecom Italia and KPN maturing over the next six months, the only other emerging market telecom loan arranged in the first quarter was a $69.4 mn project loan to support Cesky Mobil's third GSM license. Otherwise, continued high prices of oil and natural gas provided further impetus to lending to the energy sector, with Argentine, Brazilian, Chilean, Indian, Mexican, Russian and Tunisian corporates coming to market.

The **sharp drop in volumes** in the first quarter reflected:

- A **flight to quality**, whereby lenders have become increasingly selective in committing to new issues. Within emerging markets, refinancings dominated market activity, with lenders tending to **move up the credit spectrum** in terms of new issues. Indeed, refinancings commanded substantially higher premiums, reflecting in some cases industry- or country-specific difficulties. For example:

  - In Asia, PCCW's loan **pricing witnessed a marked increase** in the margin on the three tranches of term loans soon **after** the December **launch**, despite the fact the documentation did not include any allowance for such changes. In particular, the $1.5 bn 3-year tranche was raised 35 bps to 85 bps over Libor, the $2.3 bn 5-year tranche was increased by 50 bps to 115 bps over Libor, and the $900 mn 7-year tranche by 65 bps to 145 bps over Libor. Some see this change in pricing as providing a catalyst for further use of "market flex" (allowance for adjustment of spreads to market conditions) during syndications.

  - In Turkey, Garanti Bank, in the first refinancing since Turkey's liquidity crisis in November, refinanced €350 mn of its €400 mn 1-year facility at a 145 bps all-in spread, compared with last March's deal, which paid a lower 115 bps all-in spread at the top level.

- Greater **liquidity in local markets**, which has spurred local currency denominated lending, particularly in Asia, and the growth of local bond markets.

- A reduction in liquidity available for syndicated lending with **consolidation in the financial sector**, with 2000 witnessing the JP Morgan-Chase and BNP-Paribas mergers. At the same time, a number of commercial banks report a reorientation of their activity towards investment banking, which has focused their attention on ROE, increasing their reluctance to use their balance sheets for traditional project lending. Specifically, banks indicate a **cutback in "relationship" lending**, whereby low spreads on bank loans are justified on grounds they are an unprofitable part of a bigger package of services offered (and revenues earned) by banks from their clients.

## III. Staff Appraisal

The **performance** of emerging market assets and financing remained in the last quarter, as it has over the last year, **closely tied to developments in global markets**, and in particular to developments in the US economy. With the outlook for emerging markets assets and financing remaining, in our view, inextricably linked to developments in the external environment, a key question many market observers have asked is **whether the effects of an easing of monetary policy in the US will**, or should, **outweigh the impact of** concerns about, or actual further, **slowing** in the US economy. While many took the view that an easing in US interest rates would more than offset any impact of slowing in the US, the evidence during the last quarter was ambiguous. We first reexamine the **historical behavior of emerging market assets during US interest rate cycles**. We then discuss the **"high**

**beta"** nature of emerging equity markets in a global portfolio, which has important implications for how fund managers tend to treat allocations to emerging markets in an environment of global slowing and recovery. Finally, we update our assessment of the outlook and risks for emerging markets financing on international capital markets.

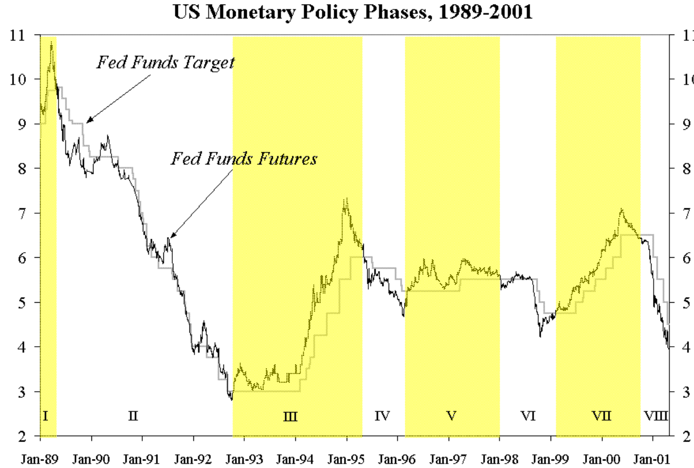
### A. US Monetary Policy and Emerging Market Assets

**Interpreting the historical evidence** on the response of emerging market assets and financing to changes in US monetary policy is **hampered by the substantial and ongoing structural changes in the composition and level of capital flows** to emerging markets that have taken place in recent decades. Key structural changes have included: the predominance of syndicated bank lending in the 1970s; the drop off in bank flows during the "lost decade" of the 1980s following the Latin American debt crisis; the births of emerging equity markets as an asset class in the late 1980s, and of emerging debt markets following the Brady restructurings in the early 1990s; the dramatic increase in household preferences for equity in the mature markets in the 1990s, and subsequent flows seeking diversification to emerging markets; the increased mobility of capital in the 1990s in response to capital account liberalization; and the rapid increase in FDI in the late 1990s.

These structural changes have been accompanied by **dramatic changes in the investor base for emerging market securities**. In the 1970s and 1980s, for example, debt claims on emerging markets were held largely in the form of seldom-traded commercial bank loans. In the 1990s, the international bond market became the largest source of finance, with cumulative net bond financing during 1994-2000 estimated at $350 bn, compared to $200 bn in syndicated loans. The growth of emerging debt markets drew in "crossover" investors from other asset classes such as US high yield and high grade fund managers, thereby tying the fortunes of emerging debt markets directly to these markets. More recently, with emerging market issuers increasingly tapping nondollar markets, the investor base for emerging market debt has continued to evolve away from institutional to retail investors.

How have emerging market assets performed during US interest rate cycles? Note that:

**US Monetary Policy Phases, 1989-2001**




- Internationally traded **emerging market financial instruments** that now comprise the asset class, and for which consistent data are available, have been **in existence for a relatively short time**, limiting the sample period to **around 10 years**: since 1989 for emerging equity markets, and 1991 for the debt markets.

- There are a number of ways in which one could **define the**

**turning points of interest rate cycles**. We identify the end of a cycle by the **joint behavior** of the **federal funds target rate** and the **yield on federal funds futures**, with the latter representing expectations of the former. A typical feature of tightening (loosening) cycles is that the yield on interest rate futures exceeds (is lower than) the policy rate for a prolonged period (see chart above). We identify turning points by the time at which the **yield on federal fund futures "crosses over" the trajectory of policy rates** as it changes direction. Since January 1989, which is the first date for which MSCI data on emerging equity markets is available, there have been **only 8 interest rate cycles**: 4 tightening and 4 easing cycles.

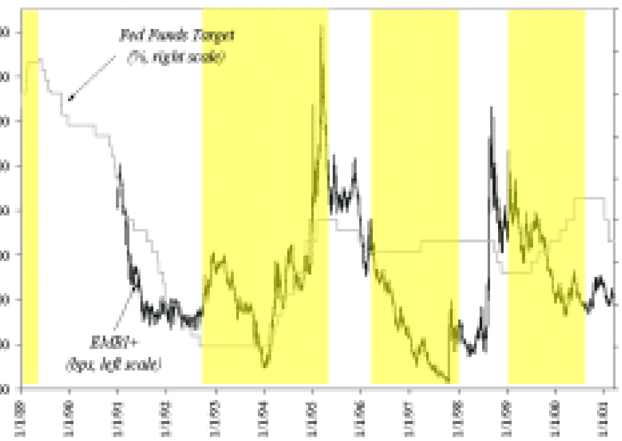
- **Evidence** on the response of emerging debt and equity markets during these 8 interest rate cycles is **mixed**. **Of the 7 interest rate cycles** for which emerging debt markets have existed, emerging market **spreads behaved as expected in only 3** (II, III, and IV), that is, cycles of US monetary policy tightening were associated with widenings of spreads and vice versa. In **emerging equity markets**, during **only 3** (II, IV and V) **of the 8 cycles** did **returns have the expected sign**, that is cycles of US monetary policy easing were associated with positive returns and vice versa. During **only 2 of the 8 cycles** (II and IV) **did *both* emerging debt and equity markets have the expected sign**. Note also that **neither** the emerging debt nor the equity markets **have had the expected sign during the last 3 cycles**.

**US Macro Phases and Emerging Markets**

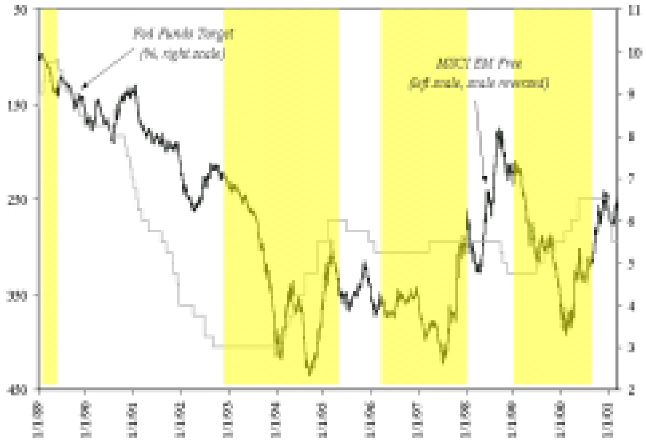
| Change in | FF Target Rate | EMBI/EMBI+ | Expected Sign? | EMF Free | Expected Sign? |
|---|---|---|---|---|---|
| **I.** (1/1/89-5/10/89) | 1.06 | - | - | 36.9% | No |
| **II.** (5/11/89-10/8/92) | -6.75 | -400 | Yes | 56.8% | Yes |
| **III.** (10/9/92-5/4/95) | 3.00 | 502 | Yes | 59.9% | No |
| **IV.** (5/5/95-3/7/96) | -0.75 | -238 | Yes | 4.3% | Yes |
| **V.** (3/8/96-1/6/98) | 0.25 | -420 | No | -17.9% | Yes |
| **VI.** (1/7/98-2/3/99) | -0.75 | 536 | No | -24.7% | No |
| **VII.** (2/4/99-9/12/00) | 1.75 | -435 | No | 37.5% | No |
| **VIII.** (9/13/00-4/30/01) | -2.00 | 131 | No | -20.3% | No |

The disparate behavior of emerging debt and equity markets during US interest rate cycles since 1989 indicates that the **path of US monetary policy**, at least as indicated by the behavior of the federal funds target rate, or for that matter by expectations of these rates measured by the yields on federal funds futures, **in and of itself has *not* been sufficient to indicate the direction of emerging market spreads or returns on emerging equity markets**. This empirical fact has at least two broad explanations:

US Monetary Policy Phases - Emerging Debt Markets




US Monetary Policy Phases - Emerging Equity Markets




- The **federal funds rate, or its expectation** embodied in futures **may not be the relevant indicator of monetary policy**. It can be argued that **what matters is not the level of interest rates per se**, but **whether they are viewed as effective in eventually impacting economic activity**. These expectations, it is often argued, are **best captured by the slope of the yield curve** rather than by the level of short-term policy rates. The slope of the US yield curve, as is well known, is a good—if not the best—leading indicator of economic activity. A measure of the slope of the yield curve in fact comprises a substantial 33% proportion of the Conference Board's Leading Economic Indicator series for the US. As we discussed last quarter, the slope of the yield curve also provides an indicator of the cost of market-making and for leveraged (long) position taking. Especially a disinversion, but also a steepening, should be positive for emerging market assets. The charts below compare the behavior of emerging debt and equity markets to the slope of the US yield curve measured as the differential between the yields on the 10 year and 3-month treasuries. Time periods during which the expected relationship does *not* hold are shaded and correlations for each sub-period are noted. The charts indicate **changes in the slope of the US yield curve have in fact been a much better indicator of the direction of movements in emerging market debt spreads, and especially returns on emerging equity markets**, than have been the direction of change of the federal funds target rates.

Emerging Debt Markets and the Slope of the US Yield Curve


Emerging Equity Markets and the Slope of the US Yield Curve

Though changes in the slope of the yield curve have been much better indicators of the direction of emerging market assets, they have **not always** been so, **nor has the correlation been stable**, indicating that other factors matter.

- There is a **host of other factors** besides US monetary policy that **jointly determine emerging market asset prices**.

  - First on this list would be **emerging market fundamentals**, including economic activity and credit quality.

  - In the context of the **external environment**, we would point out especially the direct role of economic activity, and note that in the limited sample over which international emerging market assets in their current form have been in existence, the **only US recession in 1990-91** occurred at the very beginning of the sample period **for emerging market equities**. There is in fact only one observation, on the basis of which many observers have extrapolated to determine the prospective behavior of emerging market equity at the current juncture. The **birth of emerging debt markets postdates the 1990-91 US recession** and, were a recession to occur in the US, as some anticipate, it would be the first for the asset class. **Why does a recession per se matter rather than just the level of economic activity or growth?** In our view, because these are **episodes prone to flights to quality** and diminished risk appetite, with negative implications for emerging markets that fall lower on the credit spectrum.

  - There are a variety of **other factors** that impact the behavior of emerging market assets and financing. In emerging debt markets, we have noted in past quarterly reports the role played by the **broader state of credit markets**, especially the US high grade and high yield sectors. Obviously, **financing needs** of emerging market countries and the extent of actual **issuance** (supply of paper) in both debt and equity markets can be expected to impact price performance.

  - Finally, **technical** factors, such as the over- or under-weight positioning of investors matters. We argue in the next section the underweight positioning of investors at the end of last year played a key role in the substantial January rally across emerging equity markets.

In summary, we conclude that **US interest rate cycles do matter for emerging market assets**, but the **relationship is not a simple one,** and it is likely that **a host of other potential factors also do**.

## B. Emerging Equity Markets: High Beta Assets in a Global Portfolio

A salient feature of **emerging equity markets** is that they are generally viewed as, what the Capital Asset Pricing Model terms, **"high beta"** assets in a global portfolio. As is well known, the beta of an asset (class) represents—in a well diversified portfolio—its contribution to the risk of the portfolio. What is the same thing, the beta of an asset measures the sensitivity of that asset to movements in the overall market. The presence of an asset with a beta greater than 1 tends to amplify the movements in any portfolio of a movement in the broader market, while the presence of assets with a beta less than 1 tends to dampen them. The table presents estimates of betas for the major emerging equity markets (measured by returns on the respective MSCI indices) relative to the global equity market (proxied by the MSCI All Country World Index) using monthly returns for 1995-2001. Not only the **broad emerging markets** and **regional indices**, but **each and every major individual country emerging market** is estimated as having a **beta above 1**. These high betas were in evidence during the spectacular January rally in a variety of markets with, as discussed above, a number of emerging equity markets gaining around 30% in January following the Fed's first cut in interest rates.

***Emerging Market Betas (sample period: Jan-1995 to Mar-2001)***

| | Betas vis-à-vis ACWI Free | Weight in ACWI Free (in percent) |
|---|---|---|
| **EMF** | 1.44 | 5.03 |
| **Asia** | 1.35 | 2.26 |
| **Latin America** | 1.58 | 1.30 |
| **EMEA** | 1.35 | 0.98 |
| Russia | 3.05 | 0.10 |
| South Africa | 1.97 | 0.49 |
| Brazil | 1.83 | 0.53 |
| Mexico | 1.73 | 0.48 |
| Korea | 1.67 | 0.47 |
| Singapore | 1.58 | 0.45 |
| Malaysia | 1.40 | 0.32 |
| Hong Kong SAR | 1.39 | 0.96 |
| Turkey | 1.30 | 0.14 |
| China | 1.23 | 0.33 |
| Taiwan Province of China | 1.11 | 0.74 |
| Chile | 0.98 | 0.16 |

*Source: Staff estimates*

By all accounts, **global fund managers were underweight emerging markets by the end of last year**. This reflected the view the global slowing which began to be factored in notably during September—with yields on federal funds futures falling below the target rate for the first time in this easing cycle by mid-month—would imply a poor environment for global equity markets. In a falling overall market, it made sense to shift to underweight positions in high beta assets such as emerging equity markets. The potential for a global equity market rally on the back of the **Fed's first cut in interest rates then increased the risk** (from underperformance) **of these underweight positions, spurring inflows** into emerging equity markets. Our data on foreign investor equity purchases discussed earlier are consistent with this reading of the market dynamics. Foreign investors sold off emerging equity markets during September and October last year, and recorded near-record purchases of emerging equity markets during January.

## C. Outlook and Risks

With the **performance** of emerging market assets and financing remaining in the last quarter, as it has over the last year, **closely tied to developments in global markets**, and in particular to developments in the US economy, in our view, the **outlook remains inextricably linked to developments in the external environment**. At the time of the last quarterly report we had discussed the well-known view in financial markets, with which we had concurred, that there were two scenarios: a relatively "soft" landing in the US, or at least that Fed easing would be sufficient to avoid more than a brief, shallow recession before inducing a turnaround in the economy; or that the slowing growth cycle worsened into a "hard" landing for the US economy, with output falling sharply and markets perceiving Fed easing as insufficient.

Since the last quarter, with both actual evidence of, and heightened expectations of, a sharper slowdown in the US and markedly lower expectations of growth in Japan, the questions have become **how rough the landing** will be, **whether it will entail a flight to quality** up the credit spectrum with attendant negative implications for emerging markets, and **when recovery will occur**. **Changing expectations on these outcomes** in the US will—as evidenced by the January rally, the February-March pull back, and again the April comeback—**likely keep markets volatile**.

As to the **broad implications** for emerging markets:

- In a relatively rough landing scenario, that is **a full-blown recession** in the US, we see the impact on emerging debt markets of **investors moving up the credit spectrum** dominating the impact of lower borrowing costs, widening secondary market spreads and a drying up of primary markets to new issues, very much as occurred in March-April last year at the time of expectations of an aggressive tightening of US monetary policy, and again in the fourth quarter as concerns about US slowing grew.

- Contrary to what many observers have argued, as discussed above, the **path of US interest rates alone is not sufficient to determine the outlook for emerging market assets and financing**. To be sure, cuts in US interest rates should be beneficial for emerging market borrowers and, by lowering discount rates, positive for emerging equity markets. However, a **variety of other factors also matter**.

- The **high beta** reputation of emerging equity markets makes them **prone to larger shifts in portfolio allocations on changing views** on the direction of broader markets, and the current environment suggests, particularly high volatility in emerging equity markets.

- There are **structural as well as cyclical** factors at play. The **TMT** sector remains **vulnerable to further structural downgrading**. While **long-run earnings expectations** for the broader equity market, boosted in large part during 1995-2000 by the new economy phenomena, have now been revised down for the second consecutive quarter, they remain well above their 1985-95 average, leaving **substantial room for further downgrades**.

**Emerging Market Sovereigns' Financing Needs (in US$ bn)**

| | 2001 | | | |
|---|---|---|---|---|
| Countries | Amort | Financing Needs (excl. prefunding) 1/ | Issued YTD 2/ | Covered |
| Turkey | 2.6 | 5.8 | 0.7 | 12% |
| Argentina 3/ | 5.4 | 3.3 | 1.4 | 43% |
| Brazil | 3.4 | 4.0 | 3.6 | 91% |
| Mexico | 1.4 | 1.6 | 2.2 | 141% |
| Colombia | 0.6 | 1.4 | 1.7 | 121% |
| Poland | 0.2 | 1.1 | 0.7 | 63% |
| Malaysia | 0.2 | 1.0 | 0.0 | 0% |
| Philippines | 0.7 | 1.0 | 0.1 | 13% |
| Venezuela | 0.9 | 1.0 | 0.5 | 47% |
| Other 4/ | 1.1 | 1.5 | 0.8 | 49% |
| Total | 16.4 | 21.7 | 11.7 | 54% |

1/ Average of market estimates.
2/ April 14, 2001.
3/ Authorities' revised financing program, May 4, 2001.
4/ Includes Chile, Bulgaria, Panama and Russia.

Beyond these broad implications, there are issues specific to emerging bond, equity and loan markets that will impact secondary market performance and the volume of financing on international capital markets, which we discuss below. Our **baseline outlook** for overall financing to emerging markets is predicated on the current external environment in financial markets continuing to prevail. We continue to see **moderate bond financing flows**, **reduced prospects for selective equity issuance**, and some early signs of a slowing in **syndicated loan flows** though we expect the market to remain broadly supportive.

On emerging **bond markets**:

- **Emerging market issuers** took advantage of the rally in January until mid-February to **successfully pre-finance much of their issuance needs for 2001**. The major **exceptions were Turkey and Argentina**, where the market remains uncertain about these sovereigns' actual 2001 financing needs. At the other end of the spectrum, Mexico and Colombia have completed their external financing programs, opportunistically accessing markets since, while Brazil has nearly completed its financing requirements for 2001.

- As the poor external environment combined with the deterioration in emerging market fundamentals **limits market access to the top borrowers**, we expect **emerging market borrowers to seek innovative** and structured instruments **to improve access**. Potential features we are likely to see again in the near term include: collateralization, embedding bond warrants, step-downs, floating-rate notes, and put options, all to "buy down" issuance spreads.

- We expect emerging market issuers to continue to rely **more heavily on euro and yen denominated issuance** as they did increasingly during the last quarter (see table).

**Currency of Issuance**
***(Shares in %)***

| | 99Q4 | 00Q1 | 00Q2 | 00Q3 | 00Q4 | Jan-01 | Feb-01 | Mar-01 | 00Q1 |
|---|---|---|---|---|---|---|---|---|---|
| U.S. dollars | 53 | 62 | 51 | 65 | 60 | 70 | 55 | 36 | 57 |
| Euro | 37 | 33 | 28 | 18 | 21 | 30 | 32 | 34 | 31 |
| Yen | 8 | 3 | 17 | 14 | 13 | 0 | 9 | 17 | 7 |

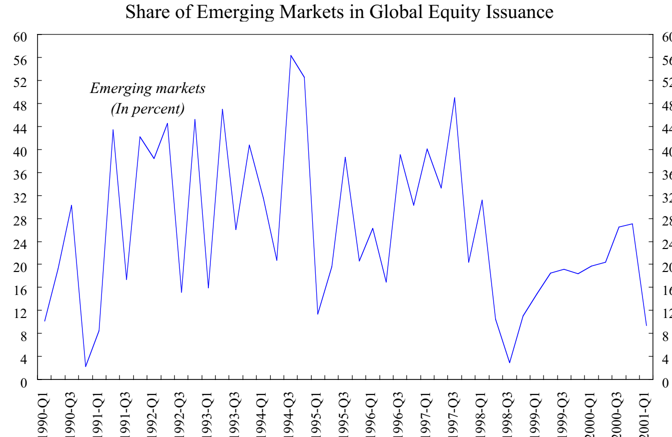
- The devaluation in Turkey, and more significantly the renewed turmoil in Argentina, has led to one of the **strongest technical positions in the emerging debt market since the Russian crisis**. Cash holdings of dedicated investors are at record high levels, and limited new issuance and cash flows from amortizations and interest payments has continued to raise them further. The

**potential for emerging markets to rally** for technical reasons, therefore, remains substantial.

- The **crossover investor base** for emerging market debt **may have suffered a significant setback during the last quarter**. While the high yield crossover investor benefited from having emerging market debt exposure during 2000, as US high yield underperformed, the roles shifted during the first quarter. In addition, significant emerging market headline risk and a deceleration in high yield inflows have reduced this investor base's buying appetite. Given the ongoing turbulence in emerging markets, we see the structural **shift towards the Lehman Universal from the Lehman Aggregate by high grade fund managers, which we have discussed in detail in past quarterly reports as being positive for emerging markets, as being delayed.**

- As expected, following the successful completion of several sovereigns' financing needs, the focus of their activities has shifted towards liability management operations and given sufficient windows of opportunity, **Brady-eurobond swaps** (or outright buybacks) **in 2001 could reach or even exceed 2000's record levels**.

Share of Emerging Markets in Global Equity Issuance




On **emerging equity markets**, we continue to see **secondary markets** buffeted by developments in the mature, and especially the US, equity markets. As noted above and in past quarterly reports, with the **TMT sector representing a larger component of emerging** than mature equity markets, especially in Asia, they remain most vulnerable to a downgrading of the earnings potential of the TMT sector. With emerging equity markets having a **track record as being more volatile** than their counterparts in the mature markets for a variety of reasons, **correlations across markets boosted** by the sectoral link from the performance of the TMT sector, and global equity markets taking their cue for broad direction from **signals of global slowing**, emerging equity markets are **likely to continue to be treated as "high beta"** in the near term. This will keep them vulnerable to sharp fluctuations in allocations and thereby perfromance. The difficult conditions in international markets prompted international equity placements by emerging markets in the first quarter to fall off sharply. With reports of some Chinese issuers, the largest share of the pipeline for this year, switching to domestic markets to make placements, while there should be less potential for "crowding out" other emerging market borrowers, we see the overall prospects for international placements as having diminished further.

While **syndicated loan volumes are expected to moderate** in 2001 from last year's robust outcome, the second and third quarters will likely witness a **pickup** from the first, as banks' internal risk limits to emerging markets, established at the beginning of the year, remain underutilized. Across regions the reported **pipeline is busy**. Emerging market telecom financing will likely remain muted through the remainder of 2001 under the shadow of some €90 bn in 364-day facilities for European telecom companies mature over the next six months, many of which incorporate term-out options.

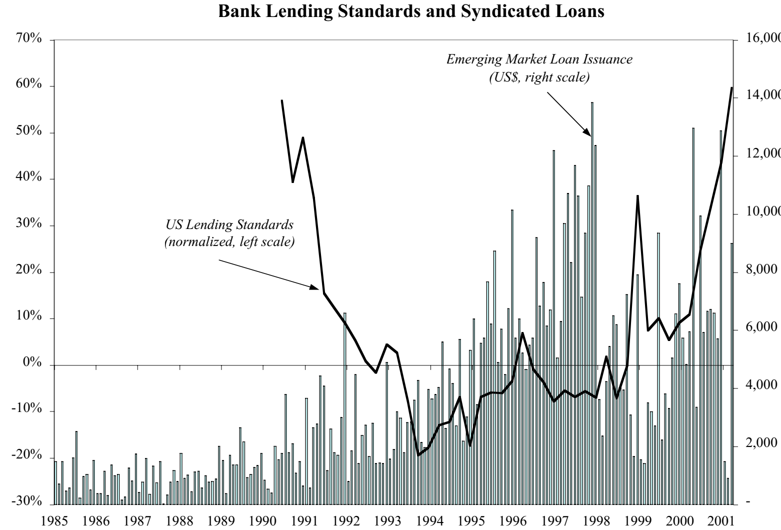
A **key question** for the syndicated loan markets is what **impact the further tightening in bank lending standards in the US** noted earlier will have on syndicated loan flows to emerging markets. With the data on bank lending standards only available since 1990, history provides only limited guidance (see chart). Note that:

- The notable sharp **tightening** in bank lending standards **following the Russian-LTCM crisis** was **associated with a sharp drop off in syndicated loans to emerging markets**. At least on occasion, therefore, there is a link.

- The **steady tightening in bank lending standards since mid-1999 did not appear to have any discernible impact** on the volume of syndicated loan flows to emerging markets.

- The **recent tightening** in standards has now, however, taken them **to levels not seen since collection of the data began** and suggests it is approaching 1989-90 recession levels.

**Bank Lending Standards and Syndicated Loans**




In our view, **as we approach extremes**, brought on for example by a recession in the US, the **more likely there will be a negative impact** on the volume of bank lending flows. We see the recent tightening in bank lending standards as having **increased the downside risks** for syndicated lending to emerging markets.