International Developments

Data for 1999:1Q reveal a continued drop in the exposure of U.S. banks to key developing economies. Exposure to Brazil has continued its sharp decline, consistent with concerns about the impact of Brazilian fiscal policy on the value of the country's currency. However, despite concerns about contagion effects within Latin America, exposure to Mexico has increased. This may be related to Mexican policy changes, such as the decision to facilitate foreign ownership of Mexican banks. On the other hand, developments in the U.S. economy might have affected the foreign-lending exposure of our banks. In particular, the strong U.S. stock market has made foreign lending relatively less attractive and might explain why, contrary to speculation, flows do not appear to have been diverted from Latin America to Asia.

The perception of increased risk in emerging markets and the associated relatively low lending volume might explain other trends in these markets. For example, the use of contingent claims commitments, associated with off-balance-sheet activities of U.S. banks, has declined for all borrowers except the G-10 countries and Switzerland. In addition, the public sectors of the G-10 countries and Switzerland have taken on an increased proportion of the guarantees those countries provide on U.S. loans to third countries. Finally, there has been no perceptible decrease in the money-center banks' share of lending, which might indicate that smaller banks do not find the market profitable enough to enter or to justify expanding their level of involvement.

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In May, the U.S. deficit in the balance on goods and services increased $2.7 billion to $21.3 billion. This reflected a $2.9-billion deterioration in the goods balance, most significantly for Western Europe ($0.7 billion), China ($0.5 billion), and Mexico ($0.5 billion); the last two of these changes resulted mainly from import increases. The continued strengthening of the U.S. dollar against most currencies contributed to these trends.

Balance-of-payments data for 1999:IQ show a decline in recorded net financial inflows from $99.2 billion to $84.1 billion. On one hand, this reflects the change in net U.S.-owned assets abroad, which went from an increase of $50.6 billion in 1998:IVQ to a decrease of $9.2 billion in 1999:IQ, mainly because of a shift to net U.S. sales of foreign securities. On the other hand, the decline in net financial inflows reflects the movement in net foreign-owned assets in the U.S., which increased $74.9 billion in 1999:IQ following an increase of $149.8 billion in 1998:IVQ. However, last year’s fourth-quarter data for net financial inflows were strongly affected by extensive acquisitions of U.S. companies by foreign ones.

The slower growth in net foreign-owned assets in the U.S. is due partly to a slower increase in net foreign official assets in the U.S. Another key development, however, was the shift from net foreign purchases of U.S. Treasury securities to net foreign sales that occurred when U.S. Treasury bond prices declined. Net foreign purchases of U.S. stocks rose, possibly indicating the strength of the U.S. economy relative to Europe.