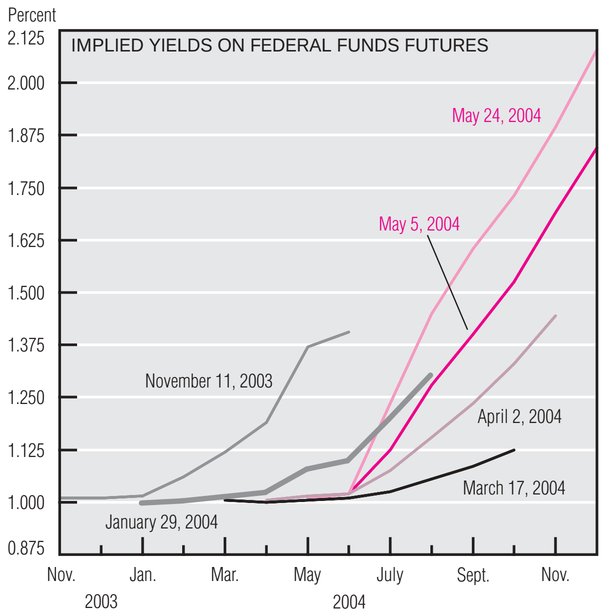
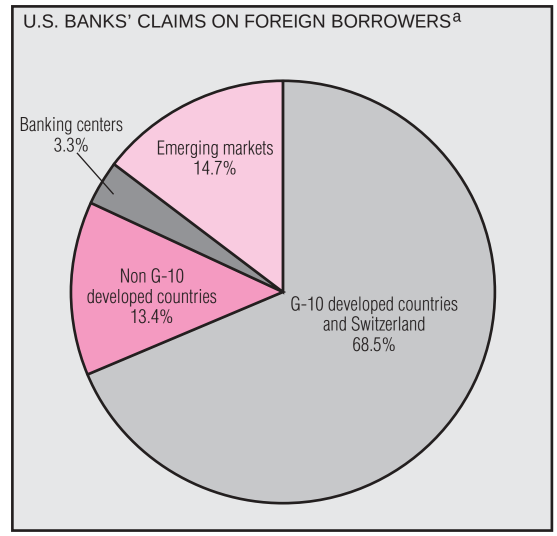
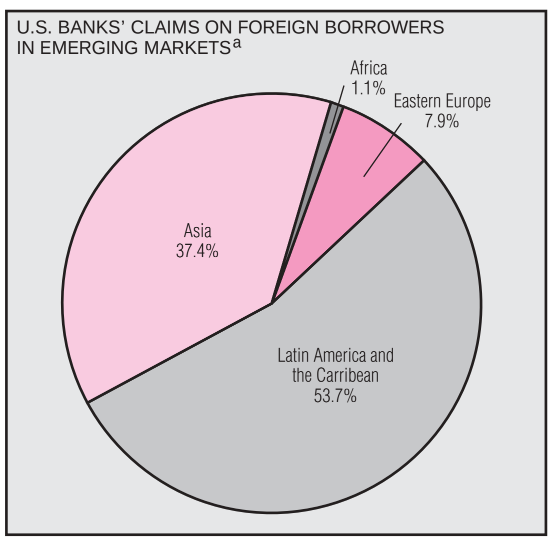
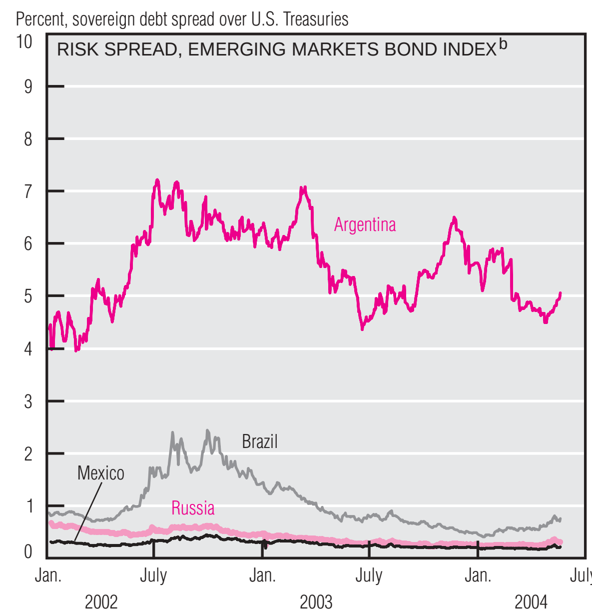
Emerging Market Debt









a. Federal Financial Institutions Examination Council, *Country Exposure Lending Survey* (March 31, 2004), Table 1. Based on a survey of 72 U.S. banking organizations.

b. Data from J.P. Morgan. Includes external-currency-denominated Brady bonds, loans, and eurobonds as well as U.S. dollar-denominated local market instruments.

SOURCES: Chicago Board of Trade; J.P. Morgan; and Bloomberg Financial Information Services.

In late March, expectations about the future course of U.S. monetary policy began to change. As suggested by implied yields of federal funds futures, markets have come to anticipate a substantial hike in the federal funds target rate by the end of the year. Fed watchers now wonder whether rate hikes will come in a series of incremental moves or through a few large jumps. The pattern may matter.

For one thing, a sharp hike in U.S. interest rates could present particular problems for heavily indebted emerging markets and their international creditors. According to a recent survey, U.S. banking organizations hold approximately $101 billion in total claims on emerging market economies. Latin American countries account for roughly 54% (or $54.3 billion) of all U.S. bank loans to emerging markets. Our two most important Latin American debtor countries have received the great bulk of all U.S. bank loans in the region: Mexico accounts for nearly 40% and Brazil for 29%. Chile, Argentina, Venezuela, and Columbia combined hold another 19% of our total Latin American bank exposure.

As a rule of thumb, debtor countries must grow at a rate greater than the interest cost on their obligations if they hope to avoid painful fiscal adjustments and remain solvent. In March, some emerging market risk spreads, a barometer of lenders' sentiments, had already begun to widen slightly.