Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Lawrence H. Summers to POTUS re: Strategic Petroleum Reserve (2 pages)	09/13/00	P5
002. memo	Lloyd Bentsen to POTUS re: Russian Economic Reform & the Washington Summit--Building Economic Partnership (5 pages)	09/26/94	P5
003. memo	Lawrence H. Summers to Secretary Bentsen re: Memorandum to the President on Russian Economic Reform & the Washington Summit (1 page)	09/23/94	P5
004. memo	Lloyd Bentsen to POTUS re: Ukraine: Economic Reform & the Kuchma State Visit (3 pages)	11/18/94	P5
005. memo	Robert E. Rubin to Vice President Gore re: Economic Themes for Upcoming Visit of Ukrainian Prime Minister (1 page)	09/21/95	P5
006. briefing paper	re: Current Economic Situation in Ukraine (2 pages)	circa Sept. 1995	P5
007. memo	Robert E. Rubin to Vice President Gore re: Gore-Chernomyrdin Commission Meeting (1 page)	01/11/96	P5
008. memo	Under Secretary Shafer to Secretary Rubin re: Proposed Meeting with Russian Prime Minister Viktor Chernomyrdin (1 page)	circa Jan. 1996	P5

COLLECTION:

Clinton Administration History Project

OA/Box Number: 24124

FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [5]

jp34

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Other (general international)

93-143231

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 27, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin RER

SUBJECT: Failure of U.K. Bank: Barings PLC

In your economic briefing this morning, you requested more information about the failure of the U.K. bank, Barings PLC. Barings is a world-wide U.K. merchant bank with subsidiaries and affiliates that are broker-dealers, asset managers, and futures merchants. The bank, while not large in terms of capital or assets, is considered significant because it is over 200 hundred years old and had a sterling reputation. The bank filed for an "administration", the equivalent of bankruptcy, in London. The filing was caused by a huge loss, estimated at between $800 million to a billion U.S. dollars or roughly twice the firm's capital, from unhedged trading in futures and options in the Singapore and Japanese markets. It appears the unauthorized trades were the work of a single trader. The main contracts involved are a Japanese stock index(the Nikkei 225-share Average) and the Japanese Government Bond. The contracts are so large that, for example, a 1% decline in the Nikkei index would increase the loss by $70 million.

The Bank of England is the supervising entity because its primary operating company was registered as a bank in the U.K. The members of the U.S. Working Group on Financial Markets (Treasury, SEC, CFTC and the Federal Reserve) coordinated our fact finding and were in contact with the Bank of England over the weekend to understand the unfolding facts and determine what, if any, impact this failure might have on U.S. markets and financial institutions. Barings owns a medium-sized broker dealer in the U.S. regulated by the SEC which appears to have sufficient capital and no substantial financial exposure to the bankrupt affiliates. In addition, Barings owns 40% of Dillon Read; the management of Dillon Read has announced that they are willing to buy back that investment. No U.S. bank appears to have a significant financial exposure to Barings.

The initial financial market reaction to these events appears to be primarily in Asia, especially in Japan. The Nikkei declined as much as 5.46% today before recovering to close down 3.8%. Japanese Government Bonds rose slightly in a "flight-to-quality" reaction. On the Hong Kong exchange, stock prices declined 1.1%, while in Singapore, stock prices fell 0.97%. This may have had an impact in the European markets, although there were many other factors at work. Certainly the Bank of England's reputation as a premier regulator has been tarnished, and there may be some collateral damage to the reputation of British financial institutions. U.S. bond markets continued their rally, although our stock markets were down slightly after hitting record highs last week.

In the U.S. we have regulatory structures in place that should prevent unauthorized or inappropriate risk taking, or at least limit the damage and stop systemic contagion. At the institutional level, in addition to capital standards, our regulations stress strong internal management controls including: separate trading and control functions, limits on position taking and counterparty exposures, and regular information reporting. On the broader market level, the CFTC has large trader position reports aggregated across the U.S. futures exchanges on a daily basis. They use this information to spot large or unusual positions in the U.S. futures markets and question the exchanges and the positions takers. They also work closely with the other U.S. regulators to alert them to potential problems and combine information from the futures and cash markets. Unfortunately, it is impossible to prevent stupidity or fraud, but systems and surveillance can limit the extent of the problems that result from either.

I will continue to monitor this situation closely and will keep you informed as to further significant developments.

Background on Barings PLC

- After suffering losses in Asian markets that press reports put as high as $1 billion, Barings filed for "administration" (apparently similar to a Chapter 11 bankruptcy in the U.S.). Britain's High Court appointed Ernst & Young to be the administrator.

- The Bank of England had previously attempted to devise a bailout of Barings involving other British banks, but it was unable to do this. Efforts are reportedly still ongoing to have Barings acquired by another bank.

- Barings has a large asset management operation that it could presumably sell in order to meet its liabilities.

- According to the SEC, Barings was long $5.5 billion (notional) in Nikkei futures on the Simex (Singapore) and Osaka exchanges as of Friday's close. It was short $16 billion in Japanese Government Bond futures on the Tokyo Stock Exchange. As of Friday, it had lost $500 million on Nikkei futures and $140 million on the JGB futures. (We are attempting to obtain more information concerning the time period over which these losses occurred, the status of variation margin payments to the clearinghouses, and the extent to which these contracts have now been liquidated.)

- A 28-year old trader in the Singapore office of Barings is being blamed for the losses. The <u>Wall Street Journal</u> reports that the trader has "disappeared."

- The British parent bank advanced the funds to make margin calls on the Asian exchanges. The problem for the parent bank is that these loans to its subsidiary apparently now have no value. It is not clear why the parent bank did not spot a problem earlier, since it was advancing funds and there was no inflow from other positions.

- The Monetary Authority of Singapore has issued a statement that the Simex has adequate resources and that no customer funds are in jeopardy.

- Out of an outstanding 27,000 contracts Barings had on Simex on Friday, 7,000 contracts have been liquidated.

- According to the CFTC, the Tokyo Stock Exchange has frozen Barings' positions. It is not clear why they did this rather than attempt to liquidate the positions as Simex is doing.

- A press report indicates that Barings had entered into "short straddle" positions in the Nikkei on Simex late last year. This, according to the report, was a bet that the market would not move much, but the Japanese stock market fell and then suffered a sharp loss after the Japanese earthquake. The press report (Bloomberg News Service), relying on other traders in the market, goes on to state that Barings then "bought an estimated 15,000 to 20,000 futures contracts on the Simex and Osaka Securities Exchanges, the four traders said. That's a $3.4 billion bet -- a bet so big that Barings was hoping it would pull futures prices, and the Nikkei average, up with it."

- Other reports suggest that Barings sold puts in order to use the premium to meet margin requirements on the futures exchanges. We do not have any hard information on this.

- According to the SEC, major U.S. broker-dealers have no significant credit exposure to Barings. The bank regulators indicate that there are no significant U.S. bank exposures to Barings. There is one bank with an exposure of over $100 million. All other banks have exposures that are much less.

- Barings owns 40 percent of Dillon Read. This is a passive investment. Apparently, Dillon Read management, which owns the other 60 percent, could buy out Barings' share. The New York Stock Exchange will call Dillon Read today.

- Baring owns a medium-size U.S. broker-dealer that we understand has sufficient capital.

- The Japanese stock market was down as much as 5.46 percent today, but closed down 3.8 percent. Other major Asian markets showed lesser declines, for example, the Kuala Lumpur index fell 1.72 percent. The Taiwan benchmark equity index fell 3.15 percent. Most European stock markets were down less than 1 percent this morning. U.S. financial markets do not appear to have been affected in any significant manner to the Barings situation.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 27, 1995

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: DEPUTY SECRETARY NEWMAN FNN

FROM: Darcy Bradbury DB
Deputy Assistant Secretary (Federal Finance)

SUBJECT: Memo to President on Failure of Barings PLC

ACTION FORCING EVENT:

In the economic briefing meeting this morning, the President requested a briefing memo on the failure of Barings PLC.

RECOMMENDATION:

That you sign the attached memo to the President.

__✓__ Agree _____ Disagree _____ Let's Discuss

ATTACHMENTS:

Tab A: Memo to President
Tab B: Background on Barings PLC

TREASURY CLEARANCE SHEET

NO. ____________
Date 2/27/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☒ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____________

FROM: Darcy Bradbury
THROUGH: Deputy Secretary Newman
SUBJECT: Memo to President on Failure of U.K. Bank, Barings PLC

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ____________

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Darcy Bradbury				
REVIEWERS				
			NCC to JBN (signature) 2/27/95 JBN to REK 2/27/95 Please Log In	

SPECIAL INSTRUCTIONS

2

1996-SE-002567

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 11, 1996

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: Robert E. Rubin RER

SUBJECT: National Economic Strategies

This is a somewhat belated response to your question some time ago about other countries' economic strategies that might be instructive to the United States. You specifically mentioned Denmark. Having recently returned from an APEC Finance Ministers' meeting, I was struck again by the truly remarkable transformation of most of these countries from impoverishment thirty years ago to consistent growth and enormous improvements in levels of prosperity today. Moreover, many of their strategies -- though not all -- are consistent with the strategies the President has pursued for our economy.

Most Asian developing member nations have very low deficits and some, notably Thailand and Singapore, are running fairly substantial budget surpluses. By and large, these countries invest heavily in education, and are extremely focussed on promoting exports. As to differences, they generally have much higher levels of savings and, with only two exceptions, have significant barriers to free trade -- though these are gradually coming down.

Denmark, by contrast, is more typical of Europe as a whole. As you can see from the attached memo, Denmark instituted a very generous and expensive social safety net. While it reduced poverty, this program has produced unintended and harmful consequences such as disincentives to work, high minimum wages that price low-skilled workers out of the market, high levels of unemployment, and very low levels of new job creation. 1995 taxes and public sector spending accounted for 60 and 62 percent respectively of Denmark's economy, more than double the comparable figures for our economy. Moreover, Denmark currently is registering an unemployment level of 9.1 percent, down from 12 percent in 1993, and a roughly zero rate of growth.

As you know better than anyone, the President has had a comprehensive and sophisticated economic strategy from the beginning of this Administration, and has either added on or fleshed out elements through the past three years. Because of cultural, demographical and other differences, it is always difficult to judge the applicability of the experiences of other countries, but clearly there is much food for thought in these experiences, good and bad -- perhaps for now but especially in thinking about additions to the economic program to be pursued in the second term.

I know that our offices have been trying to set up the dinner we talked about, in conjunction with Laura. More generally, I think it would be a good idea for you to have some sort of periodic dialogue on these economic issues, to provide a better framework for your discussions elsewhere.

On another matter, you asked about tax laws that encourage Americans to invest abroad. I am told current law does not discriminate in favor of foreign investment. It is also worth noting that a substantial fraction of American exports follow overseas investment.

Attachment

NCC original
to White House
- Already logged
in from OASIA
please file
4/11/96

Denmark

Denmark is at an interesting point in its national economic strategy. In recent years, it has chosen to preserve its generous safety net and to use austere macroeconomic policies (including closely linking its exchange rate to the ERM) as a means of lowering inflation and reining in unsustainable fiscal deficits. Overall, its fiscal policy has been tight, but deficit reduction has been achieved primarily through tax increases rather than spending cuts. Growth slowed to an average of 2 percent during the transition from 1987 to 1993, quickened through mid-1995, but fell back to zero since then and has remained flat.

The government's generous income redistribution policy has come at a hefty price. In 1995, the OECD estimated that Denmark had the highest tax burden in the OECD at 59.7%, and after Sweden, the highest level of government spending at 61.6% of GDP.

While it successfully lowered inflation, Denmark's high level of structural unemployment did not drop as much as expected during the recent expansion. In December, Denmark's unemployment rate was 9.1% compared to its previous high of 12% in 1993. Generous unemployment benefits have reduced poverty, but also, have significantly reduced the economic incentives for active job-seeking. Unemployment benefits cover up to 90% of the wages of some low paid workers for up to seven years. Similarly, job training programs provide full unemployment benefits to workers choosing to return to school. While designed to encourage skill acquisition and job rotation, these programs have been loosely administered, and have created real negative incentives to work.

The government is responding to these problems by improving work incentives. These efforts include: reducing the tax rate on most employees; broadening the tax base; and reducing eligibility for unemployment benefits to five years.

1999-SE-002636

DEPARTMENT OF THE TREASURY
WASHINGTON

March 15, 1999

NOTE FOR DEPUTY SECRETARY SUMMERS
UNDER SECRETARY GEITHNER
UNDER SECRETARY GENSLER
ASSISTANT SECRETARY TRUMAN

FROM: Caroline Atkinson CA

SUBJECT: Systemic Risk from International Financial Crises

The attached notes and charts from a presentation by Lewis Alexander (FRB) are interesting.

They show that:

- The recent incidence of international financial crises is not extraordinarily high by past standards;
- In the US traditional systemic vulnerability (through bank credit exposures) to international crisis is now far lower than in the 1980's;
- US banks contributed less than Japanese and European to the run up in exposures in the latest crisis, probably reflecting better risk management;
- However, exposures through them in the derivatives (and market risk) are proportionally much greater now, complicating risk management, and;
- The spillover from emerging markets volatility to US markets was negligible in 1994-1995, still small in 1997 – early 1998, and then substantial after Russia.

CC: DAS Zelikow
DAS Medish
DAS Sachs

Done

DIVISION OF
INTERNATIONAL FINANCE

Date:	March 5, 1999
To:	Governors Meyer, Kelly, and Ferguson
From:	Lewis Alexander L.A.
Subject:	Notes from my presentation to the F-6

Attached are the notes I spoke from in my presentation to the F-6. I hope to turn this material into a short paper at some point, but I thought you might find the notes useful in the meantime.

Attachment

cc: Spillenkothen, Ettin, Hooper, Henderson, Howard, Frankel, Connors, Dooley

March 4, 1999
Lewis Alexander

1) *The question to be addressed:*

a) *Has the systemic risk ~~for~~ generated by international financial crises changed?*

b) *If so how?*

c) *The basic conclusions:*

i) It is not obvious that the systemic risk generated by international financial crises has increased, but it is clear that the nature of that systemic risk has changed.

ii) In the 1980s the source of systemic risk was straightforward: U.S. banks' direct exposure to Latin governments were very large relative to their capital and the value of those loans were extremely impaired.

iii) In contrast, U.S. banks' direct exposures to Asian borrowers in the late 1990s were much smaller.

iv) However, the events of the last two years suggest that policymakers may need to pay increasing attention to the following:

(1) measuring and monitoring potential exposures arising from off-balance sheet transactions;

(2) potential risks arising from latent weaknesses in financial institutions from other industrial countries; and

(3) possible disruptive spillovers from international financial crises to other financial markets.

2) *The first issue I want to consider is ~~has~~ the incidence and magnitude of international financial crises over the last two decades.*

a) ***Exhibit 1 shows the incidence of currency and banking crises in emerging market countries. There is no obvious trend. Recent increases are not out of line with earlier experience.***

b) ***We took a more systematic look at this issue by looking at unexpected changes in exchange rates.***

   i) *We used monthly real exchange rate indices for 15 different emerging market economies in Latin America and Asia that we have calculated over the floating exchange rate era.*

   ii) *For each index we estimated a simple AR-12 model recursively.*

   iii) *For each estimation period we calculated a one-period ahead (out of sample) forecast and then calculated the forecast errors.*

   iv) *The forecast errors for the Mexican peso and the Korean won are shown in exhibit 2. These forecast errors are exchange rate shocks. Large unanticipated exchange rate changes are one indicator of international financial crises.*

   v) *The upper panel of exhibit 3 presents a measure of the standard deviation of the forecast errors. (In this measure the out of sample forecast errors are divided by the standard error of the regression used to make the forecasts. Thus a magnitude of one indicates the forecast errors have the same variance as the errors from the regression.)*

   vi) *There is no obvious upward trend. The period 1991 to 1996 was relatively calm, and the volatility of the last two years is clearly large compared to the recent past, but looking over a longer period it is not obvious that the incidence of crises has increased.*

   vii) *The bottom panel shows the incidence of errors larger than two standard deviations. This does indicate that the recent experience is extreme.*

3) ***The next question is how has the nature of the systemic risk generated by international financial crises changed.***

4) ***The systemic risk generated by debt crisis in the 1980s was very direct.***

   a) ***US banks' direct exposure to credit risk was substantial (Exhibit 4)***

b) The potential credit losses on those exposures were large and protracted (Exhibit 5)

5) The situation in the 1990s is very different

a) Direct exposures are much lower (Exhibit 4)

b) However, those exposures are more concentrated (Exhibit 6)

i) This could be problematic by increasing the vulnerability of key institutions. However, even exposures of large institutions are down. (Exhibit 4)

ii) It may help by concentrating exposures in institutions with better risk management.

c) Exposure through off-balance transactions have become more important (Exhibit 7), particularly for large institutions.

i) As exchange rates moved the value of those positions increased sharply.

ii) Even taking these positions into account, however, exposures are less than they were in the 1980s.

iii) But the importance of these exposures says something about the adequacy of existing reporting regimes. Existing on-balance sheet measures are increasingly misleading as measure of the true exposure.

d) But even taking these factors into account, the exposures of U.S. institutions have declined.

6) The lower exposures in the 1990s reflect, in part, better risk management in U.S. banks.

a) U.S. banks contributed less than others in the run up of exposure to Asian countries in the 1990s (Exhibit 8)

i) The increase in exposure by Japanese and European banks were much larger than those by US banks

b) This disparity is particularly striking when the changes in exposure are compared to changes in capital.

?

c) Work by the ECSC suggests that to a significant degree this difference in performance reflect better risk management in U.S. institutions.

7) One potential channel for international financial crises to adversely affect U.S. financial institutions is through the presence of foreign banks in the United States.

a) Foreign banks have a large presence in the U.S. (Exhibit 9).

b) A major problem in a foreign banking system, if managed poorly, could be a source of systemic risk for the U.S.

c) It is important to recognize, however, that we have already experienced such a problem with Japan. (Exhibit 9)

i) The Japanese banking system has experienced serious problems in the 1990. The presence of Japanese banks in the U.S. has contracted significantly.

ii) The contraction of the Japanese banks has had little impact on the U.S. in part because Japanese authorities have managed their problem with an eye to minimizing the international impact.

8) The last two years have reminded us of some key lessons about risk management

a) The link between market and credit risk is important—e.g., GKOs and Russian banks.

b) It is difficult to assess the likely character and potential frequency of extreme events, particularly in an environment of rapid structural change in financial markets. This dramatically complicates the problem of risk management.

9) In this context it is important to note that systemic risk can arise even when the solvency of major financial institutions is not in doubt. As the Promisel Report stressed, disruptions to financial markets can generate systemic risk. The financial market volatility we experienced last fall, and its relationship to financial crises abroad, should be evaluated in this context.

a) The financial market reactions in the period Aug-Oct of last year were significant from two perspectives:

i) *They were an extreme event that seemed out of line with previous financial market behavior.*

ii) *Those reactions appeared to be triggered by events in emerging markets.*

b) ***To assess the significance of these effects we looked at the behavior of four basic credit spreads since 1992.***

i) *The spreads considered were:*

(1) The credit spread, relative to Treasury risk, on an index of Emerging market bonds, i.e., mostly Brady bonds.

(2) The US dollar interest rate swap spread.

(3) Credit spread for AA corporate bonds.

(4) Credit spread for high-yield corporate bonds.

ii) *For each credit spread we estimated a simple V.A.R. model recursively using weekly data.*

iii) *We used these models to estimate one-period ahead forecasts and forecast errors.*

iv) *We used the forecast errors as a measure of unanticipated changes in those basic credit spreads.*

v) *The purpose of this exercise was to gauge to degree to which financial disruptions affecting emerging markets spilled over to other financial markets.*

vi) *The estimated forecast errors for the Emerging Market Bond Index and for the 10-year interest rate swap spread are shown in Exhibit 10.*

vii) *Three periods of financial disruption in emerging markets were considered:*

(1) Dec 1994 to May 1995, a period covering Mexico's devaluation.

(2) Oct 97 to Mar 98, a period that began with Hong Kong's interest rate shock and spanned the worst parts of the Korean and Indonesian financial crises.

(3) Aug 98 to Feb 99, the period following the Russian devaluation.

viii) *Both the standard deviation of the individual forecast errors and the correlation among the errors were calculated.*

ix) *The main conclusions are:*

(1) The degree to which volatility in emerging markets spilled over to other financial markets varied:

(a) Essentially no spillover following Mexico's devaluation in Dec 94

(b) Modest spillover following Hong Kong's interest rate shock in Oct. 1997.

(c) Very substantial spillover following the Russian devaluation in August 1997.

(2) Correlations across these markets were modest in the Mexican case, but they were significantly elevated in the latter two periods.

(3) The combination of high volatility and correlations across markets in the latter period is indicative of why this period was so difficult for a wide range of financial institutions.

10) Questions for policy

a) The first question for policymakers is what can be done to prevent international financial crises. There are two broad policy approaches to this problem.

i) Improve basic macroeconomic and financial sector policies in emerging market countries.

ii) Change the way we respond to international financial crises in a way that make international investors, including banks, bear a greater burden for the risk they take in extending credit to emerging market economies.

b) Given the fact that international financial crises will happen, there are several other questions worth considering.

i) Given the risks that could potentially arise from foreign banking systems it is worth considering what information should be shared among supervisors.

ii) Given the increasing role of derivatives we need to assess whether existing reporting regimes, both for individual institutions and for aggregate data, are adequate for assessing vulnerabilities to international financial crises.

iii) We need to understand the causes of the financial sector disruptions that occurred last fall--in particular, we need to understand the link to international financial crises--in order to be able to assess whether the events of last fall are likely to be repeated.

iv) Finally, we need to assess the implications of such financial market disruptions both for major financial institutions and the economy more generally.

Materials for Presentation to F-6

on

International Financial Crises and Systemic Risk

by

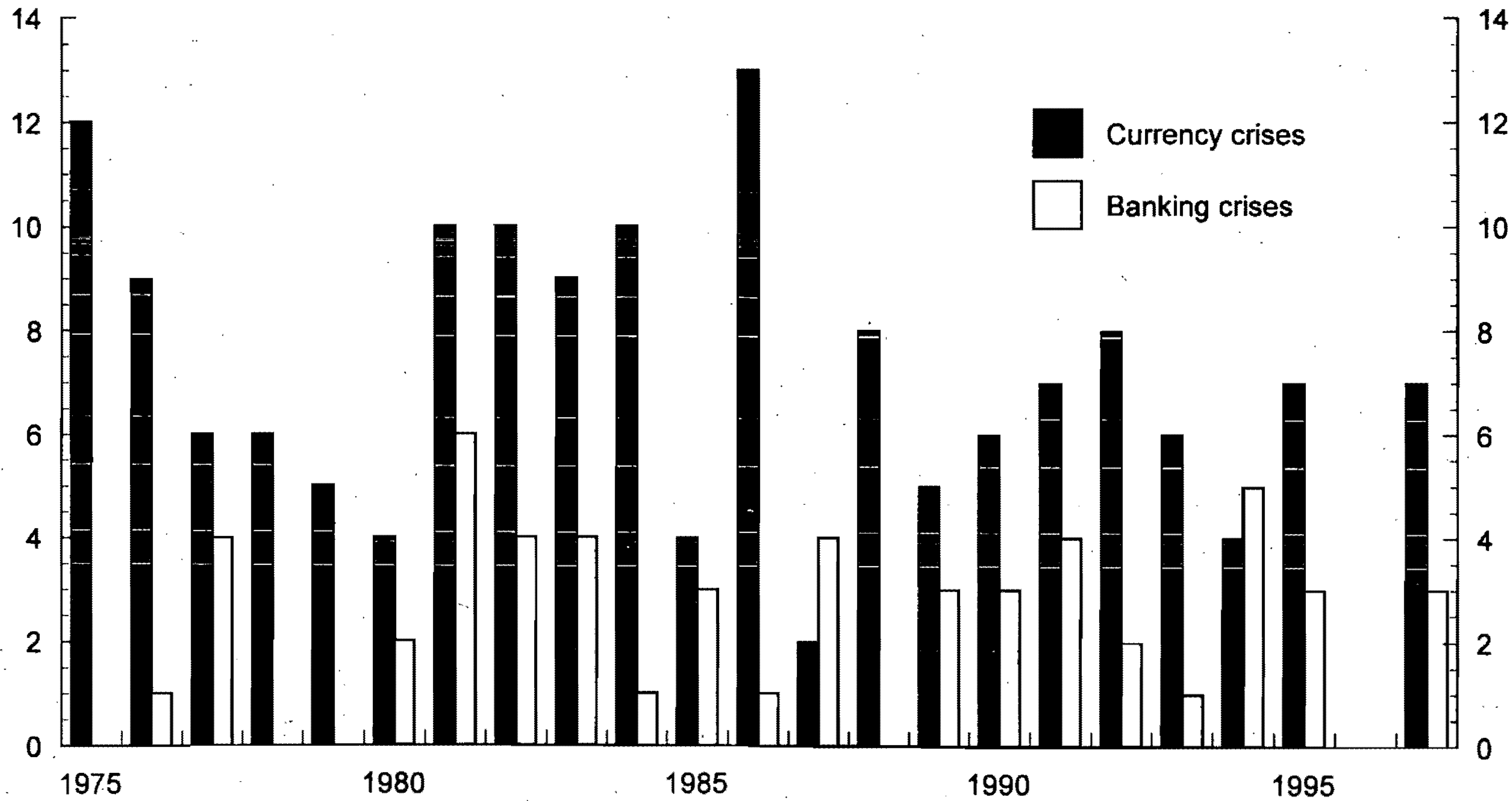
Lewis S. Alexander

March 4, 1999

Exhibit 1:	Incidence of Currency and Banking Crises in Emerging Market Countries
Exhibit 2:	Forecast Errors: Real Exchange Rate Indices
Exhibit 3:	Standardized Forecast Error for Real Exchange Rate Indices
	Incidence of Large Forecast Errors for Real Exchange Rate Indices
Exhibit 4:	Cross-Border Exposure Relative to Capital for Groups of U.S. Banks, 1982, 1997
Exhibit 5:	Indicative Secondary Market Prices of Sovereign Bank Loans
Exhibit 6:	Herfindahl Measures of the Concentration of U.S. Banks' Cross-border Exposure
Exhibit 7:	Derivative Exposure of U.S. Banks, All Reporters
Exhibit 8:	Exposure of Domestically-owned Banks to KOREA, INDONESIA and THAILAND
Exhibit 9:	Foreign Banks' Share of the U.S. Market
Exhibit 10:	Forecast Errors: Credit Spreads
Exhibit 11:	Mean Standardized Forecast Errors for Credit Spreads
	Correlations Among Forecast Errors

Exhibit 1

Incidence of Currency and Banking Crises in Emerging market Countries

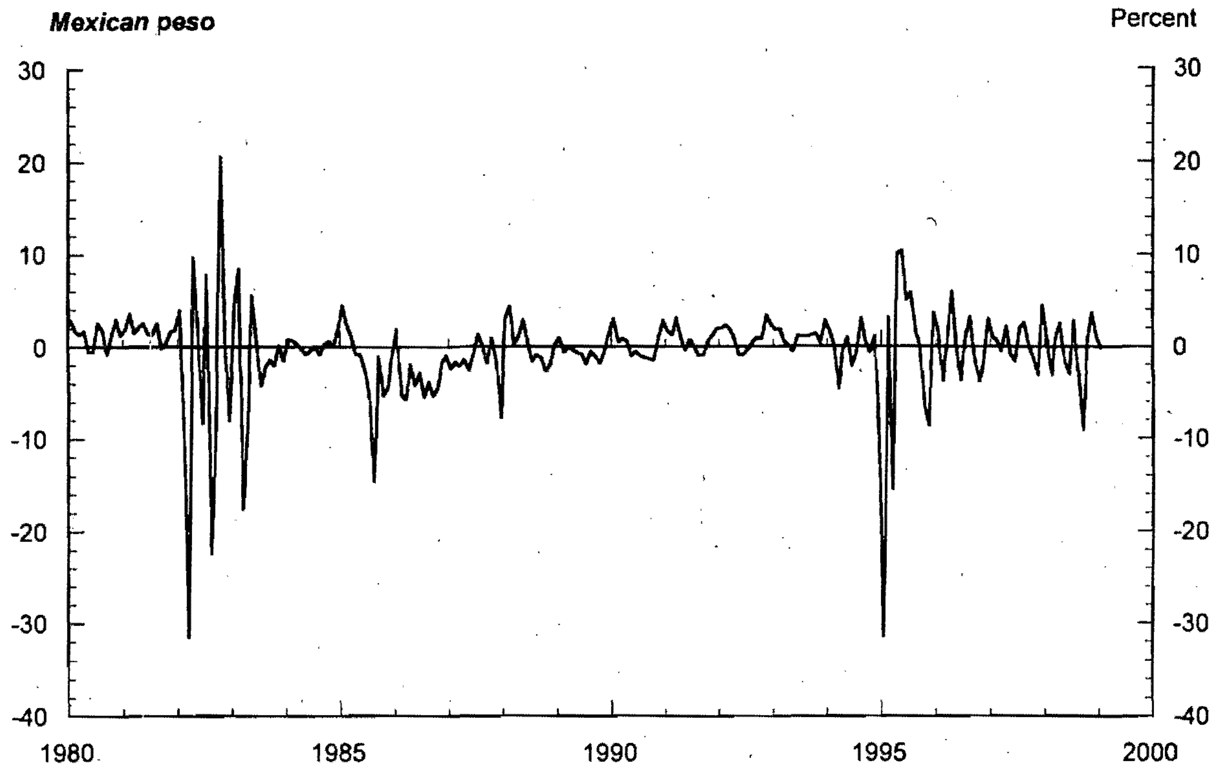


Source: IMF, World Economic Outlook, May 1998

Exhibit 2

Forecast Errors: Real Exchange Rate Indices

(monthly)



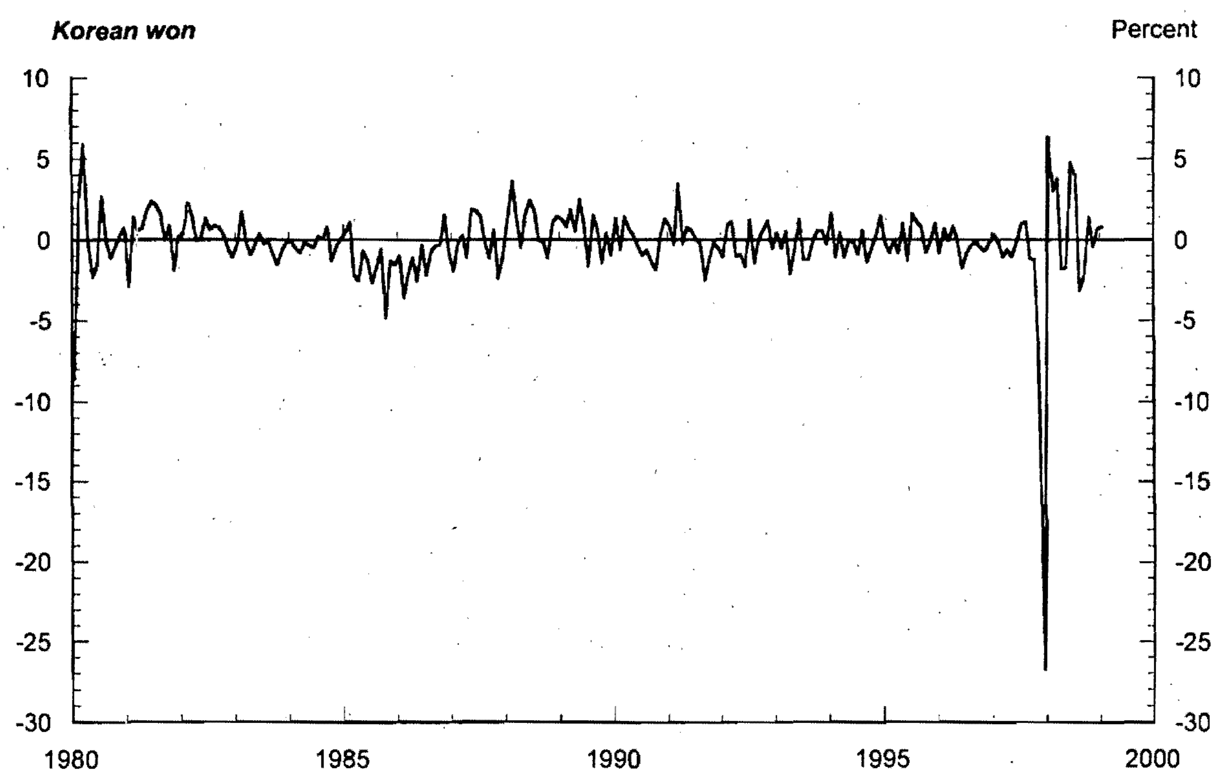
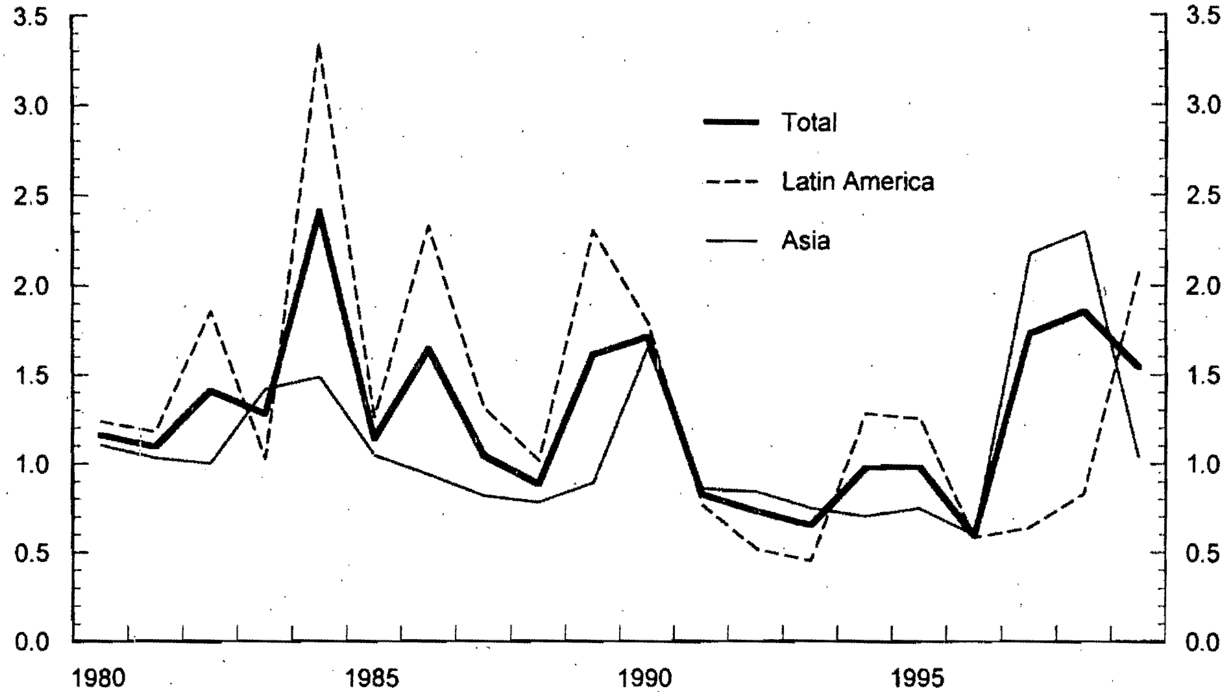


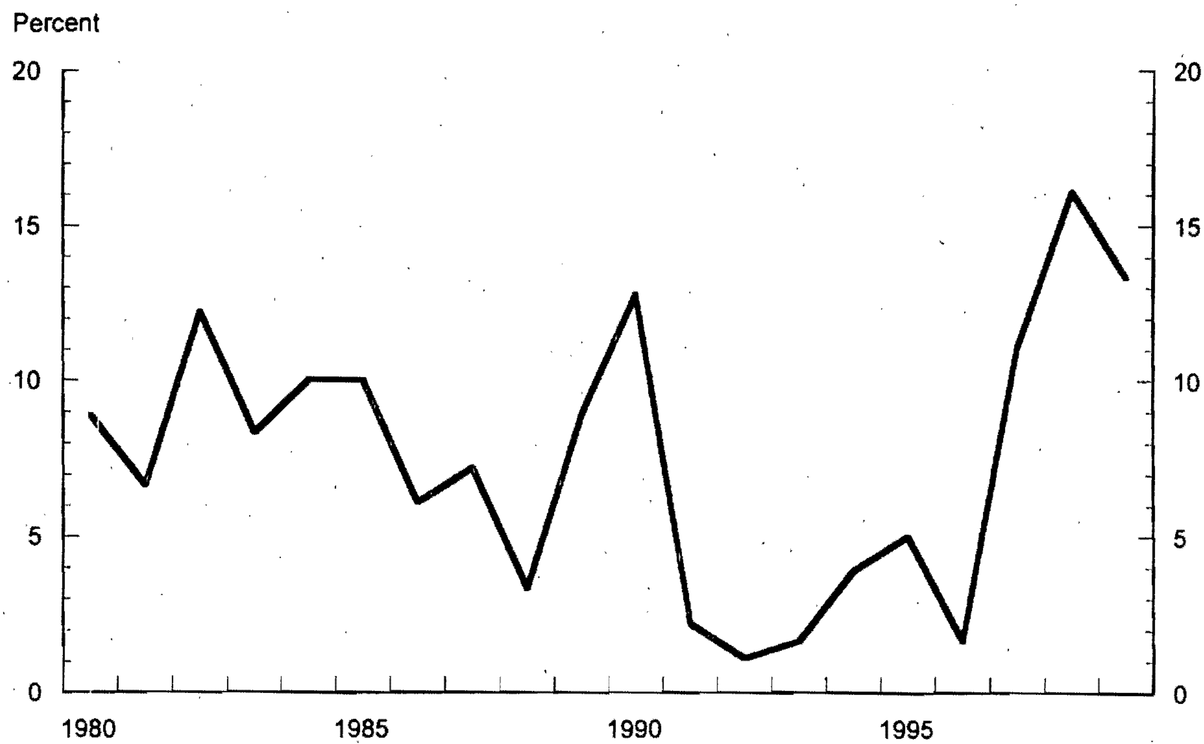
Exhibit 3

*Standardized Forecast Error for Real Exchange Rate Indicies**



* Square root of the mean of the square of one-period ahead forecast divided by standard error of the regression. If the forecast errors have the same distribution as the historical regression errors then this statistic should be one.

*Incidence of Large Forecast Errors for Real Exchange Rate Indicies***



** Incidence of one-period ahead forecast errors larger that twice the the standard error of the regression.

Exhibit 4

Cross-Border Exposure Relative to Capital for Groups of U.S. Banks, 1982, 1997[1]

(percent)

	End of June 1982				End of June 1997			
	All Banks	Money Center Banks[2]	Other Large Banks[2]	All other Banks	All Banks	Money Center Banks[2]	Other Large Banks[2]	All other Banks
DEVELOPED COUNTRIES	297	413	300	176	67	139	64	15
DEVELOPING COUNTRIES	189	287	192	87	31	63	26	9
Latin America	125	181	129	65	18	36	14	5
Argentina	13	21	14	5	3	6	3	0
Brazil	31	46	33	15	5	11	5	1
Chile	9	12	10	6	1	3	1	0
Mexico	38	50	41	24	5	10	2	2
Asia	53	86	56	20	13	26	12	4
Indonesia	4	7	3	0	1	3	1	0
South Korea	14	19	17	7	5	9	4	2
Taiwan	7	10	10	2	1	3	1	0
Thailand	3	4	3	1	1	3	2	1
TOTAL ALL COUNTRIES	519	754	521	277	108	226	95	26

Source: Country Exposure Lending Survey

[1] Exposure measured after reallocating claims from country obligor to country of guarantor. Exposure excludes derivatives-related exposures shown in Exhibit 7. Capital defined as equity, subordinated debt, and loan-loss reserves.

[2] The Money center banks include: BankAmerica, Bankers Trust, Chase Manhattan, Citicorp, First Chicago, and J.P. Morgan. Other large banks include: BankBoston Corp., Bank of New York Co., First Union Corp., Republic NY Corp., and State Street Corp.

Exhibit 5

Indicative Secondary Market Prices of Sovereign Bank Loans

(percent of face value, end of period)

	1985	1986	1987	1988	1989	1990
Argentina	64	66	34	21	13	n.a.
Bolivia	5	7	11	10	11	n.a.
Brazil	75	75	46	40	22	25
Chile	67	67	61	57	59	37
Colombia	84	86	65	58	64	35
Ecuador	68	65	37	13	14	63
Mexico	60	56	50	43	36	46
Peru	19	18	7	5	6	20
Uruguay	63	65	59	60	50	3
Venezuela	79	74	57	41	34	20
Cote d'Ivoire	74	76	40	23	6	39
Morocco	68	68	52	48	36	4
Nigeria	55	36	29	23	30	52
Philippines	57	72	50	49	49	61
Yugoslavia	84	78	49	45	51	16

Source: Salomon Brothers

Exhibit 6

Herfindahl Measures of the Concentration of U.S.Banks' cross-border Exposure

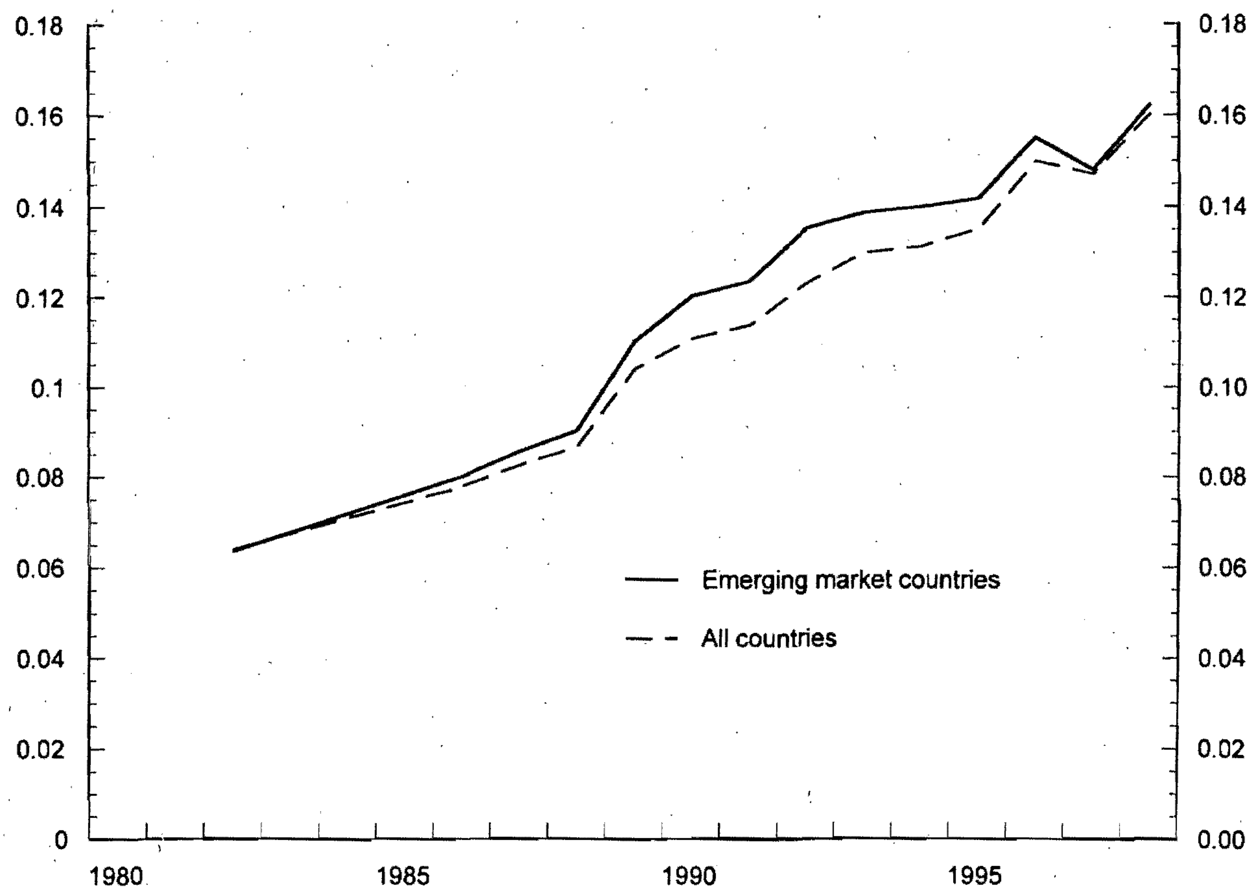


Exhibit 7

Derivatives-relative Exposures of U.S. Banks [1]

($ millions, figures in parentheses are percentages of total exposure)

	1997				1998		
	Mar.	June	Sep.	Dec.	Mar.	June	Sep.
Indonesia	447	425	2,210	2,669	1,998	1,510	973
	(7)	*(6)*	*(25)*	*(30)*	*(30)*	*(30)*	*(22)*
Korea	1,592	1,415	1,486	5,910	3,577	3,135	2,656
	(7)	*(6)*	*(6)*	*(23)*	*(16)*	*(16)*	*(15)*
Thailand	428	681	2,389	2,855	1,500	1,203	1,014
	(5)	*(6)*	*(23)*	*(31)*	*(19)*	*(18)*	*(15)*
Subtotal:	*2,467*	*2,521*	*6,085*	*11,434*	*7,075*	*5,848*	*4,643*
	(7)	*(6)*	*(14)*	*(26)*	*(19)*	*(18)*	*(16)*
Argentina	258	185	297	490	520	586	609
	(1)	*(1)*	*(1)*	*(2)*	*(2)*	*(3)*	*(3)*
Brazil	255	284	273	600	582	253	570
	(1)	*(1)*	*(1)*	*(2)*	*(2)*	*(1)*	*(2)*
Mexico	724	600	909	1,007	1,014	1,271	1,601
	(4)	*(3)*	*(4)*	*(5)*	*(5)*	*(7)*	*(7)*
Russia	6	75	898	71	144	203	157
	(0)	*(1)*	*(10)*	*(1)*	*(2)*	*(3)*	*(9)*
Cayman Islands	981	1,296	2,022	2,664	2,599	2,445	2,129
	(11)	*(33)*	*(44)*	*(24)*	*(28)*	*(27)*	*(17)*
Total:	4,691	4,961	10,484	16,266	11,934	10,606	9,709
	(4)	*(4)*	*(8)*	*(12)*	*(9)*	*(8)*	*(8)*

[1] Market value of OTC derivatives positions after netting and other adjustments.

Source: Country Exposure Lending Survey

Exhibit 8

Exposure of Domestically-owned Banks to KOREA, INDONESIA AND THAILAND

Nationality of banks[1]	Exposure Proxy[2] Dec. 1992 (billions of U.S. dollars)	June 1997	Change (billions)	Change (percent)	Change in Capital[3] (percent)
United States	13.0	32.8	19.7	152	88
Japan	41.5	78.0	36.5	88	-8
Belgium	2.4	7.7	5.3	220	106
Luxembourg	0.1	0.8	0.7	1171	81
France	8.1	21.2	13.1	162	8
Germany	5.3	22.6	17.3	327	67
Italy	1.0	2.0	1.0	101	0
Netherlands	2.3	6.9	4.6	199	67
Spain	0.3	0.9	0.7	260	n.a.
Switzerland	1.4	5.5	4.1	286	38
Subtotal:	20.8	67.6	46.8	225	35
United Kingdom	3.2	13.1	9.9	309	127
Canada	1.1	3.3	2.2	190	44
ALL BIS REPORTERS 3/	95.9	237.2	141.3	147	n.a.

[1] Data for the United States and other consolidated banking systems are for domestically owned consolidated reporters.

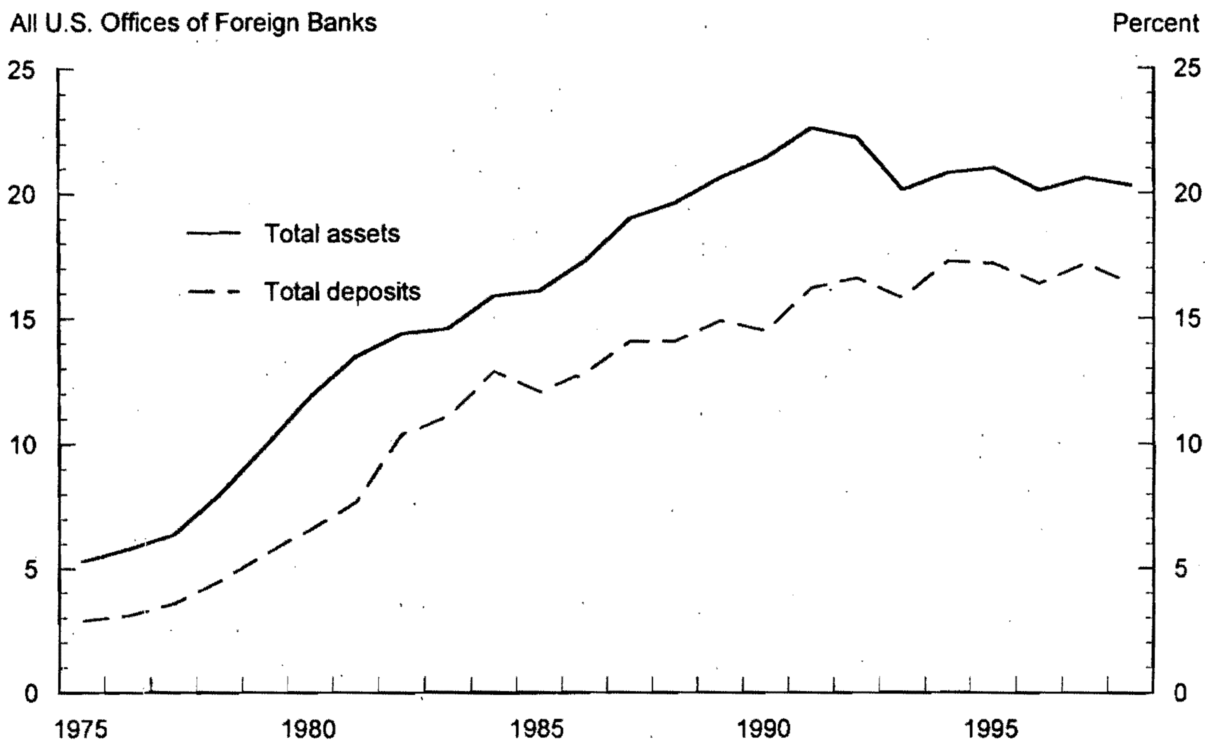
[2] Exposure proxy is total claims (which are cross-border and foreign currency claims) plus local currency less claims on branches and subsidiaries of non-local banks.

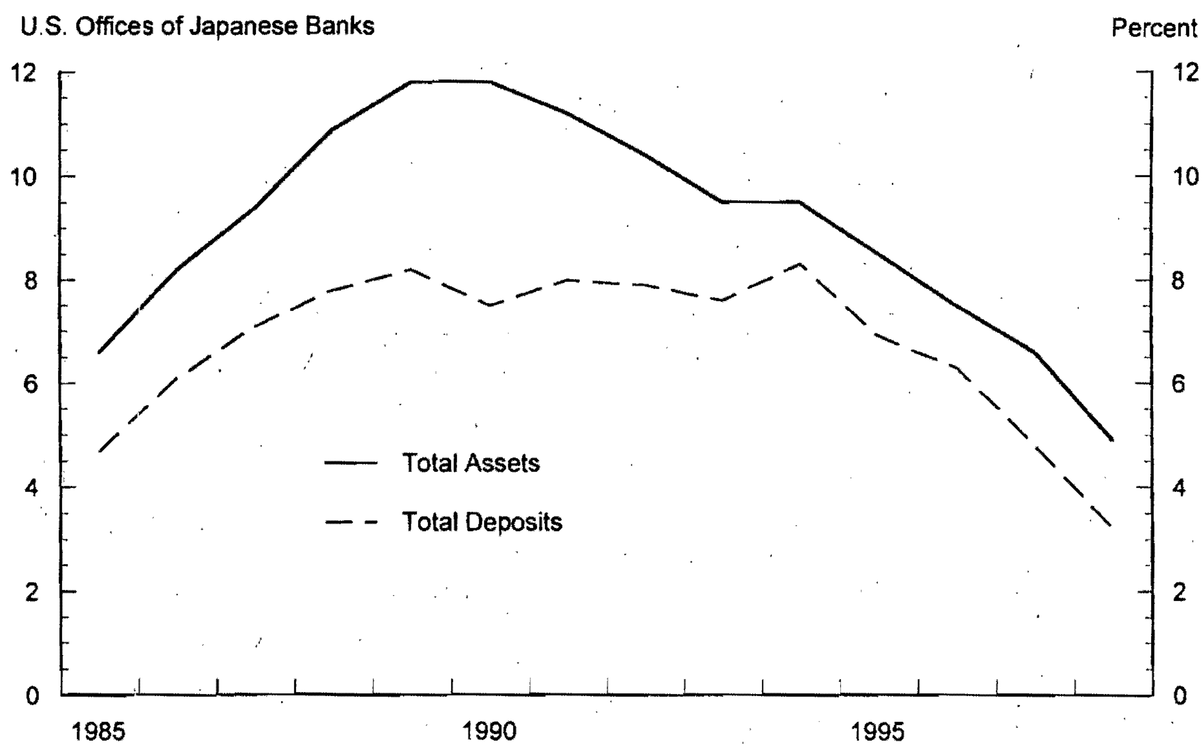
[3] Data for all BIS reporters include "domestically owned" consolidated reporters, non-domestically owned claims consolidated reporters (subsidiary banks), and unconsolidated reporters (agencies and branches of banks headquartered outside BIS countries) located in the BIS reporting countries.

Source: BIS semi-annual international banking statistics.

Exhibit 9

Foreign Banks' Share of the U.S. Market



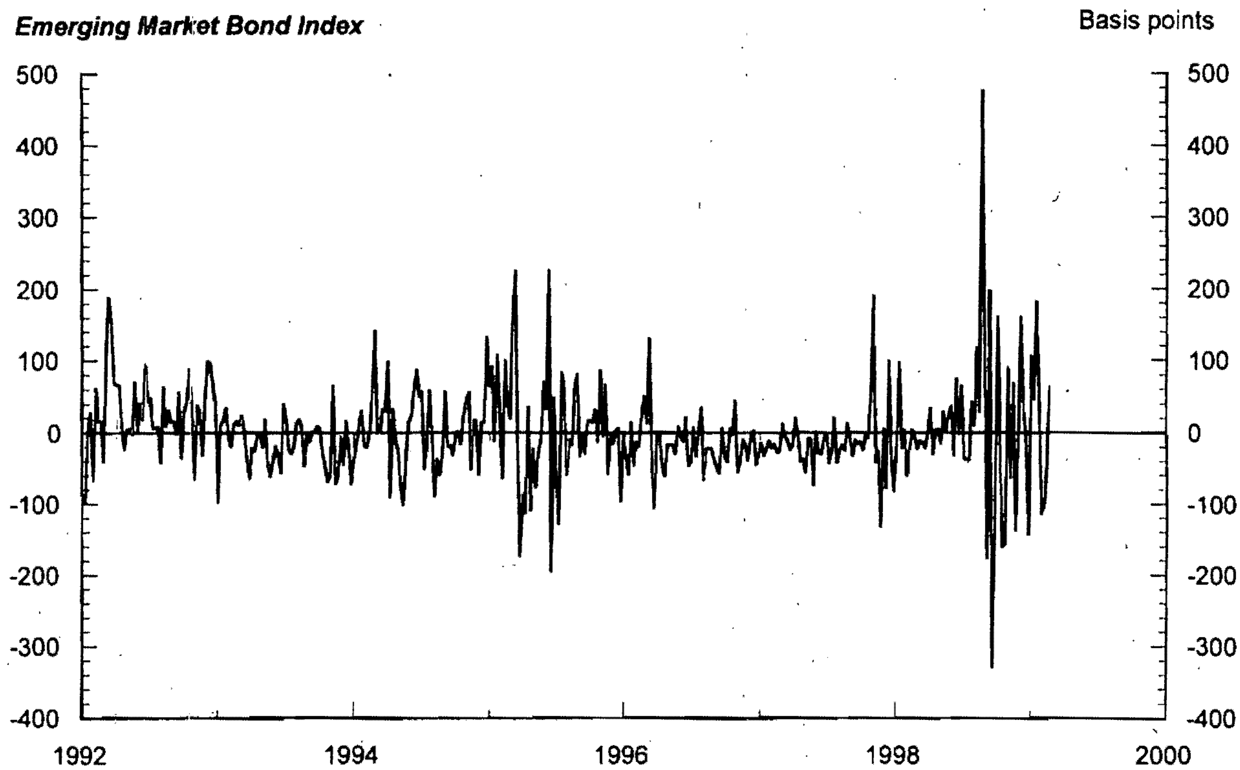


Source: FFIEC 002 and 031-034; FR 886a and 105 report forms.

Exhibit 10

Forecast Errors: Credit Spreads

(weekly)



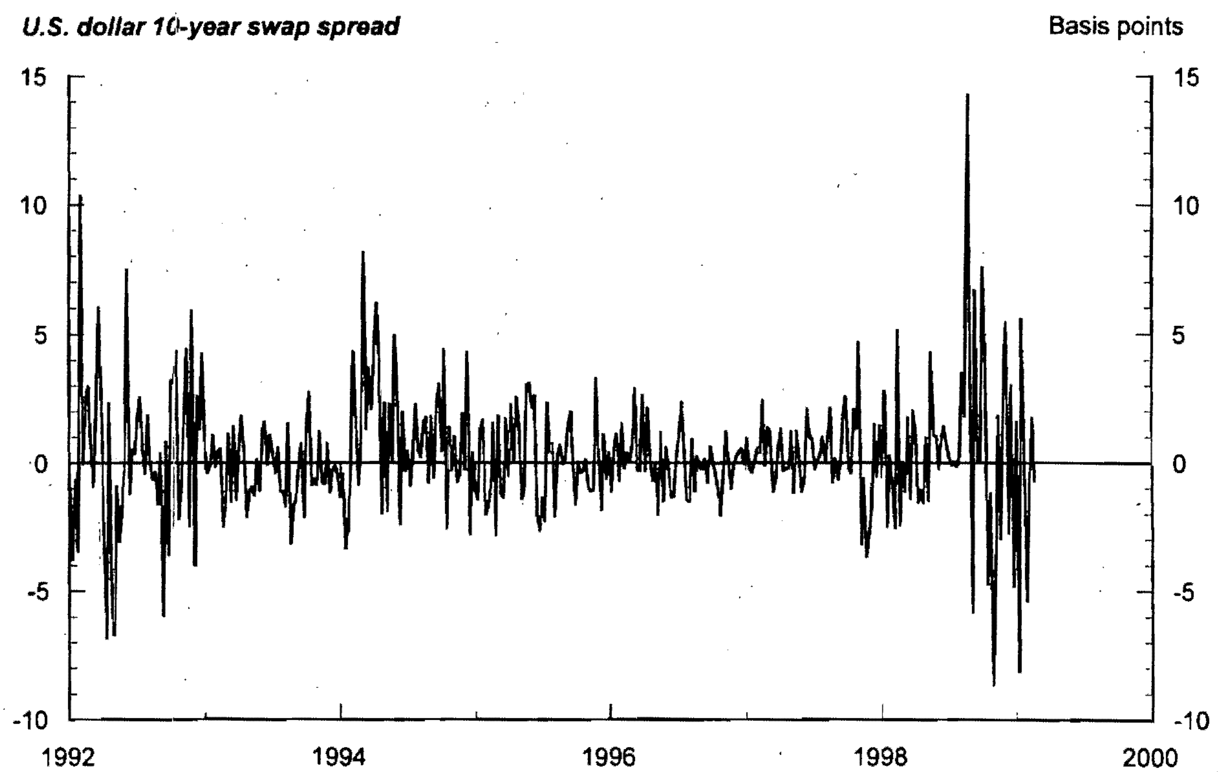


Exhibit 11

Mean Standardized Forecast Errors for Credit Spreads[1]

	Emerging Market Bond Index Spread	U.S. Dollar 10-year Swap Spread	AA Corporate Bond Spread	High Yield Bond Index Spread
Jan. 1992 to Jul. 1998	1.269	1.088	1.044	1.051
Dec. 1994 to May 1995	2.138	1.015	0.836	0.974
Oct. 1997 to Mar. 1998	1.334	1.354	1.089	0.965
Aug. 1998 to Feb. 1999	2.871	2.685	1.969	2.111

[1]Simple vector auto-regressive equations were estimated recursively using weekly data on each of the four credit spreads. One-period ahead forecasts were calculated. The figures reported are the square root of the average of the square of the forecast errors divided by the standard error of the regressions. If the forecast errors have the same distribution as the errors over the sample period then the mean standardized forecast errors should be equal to one.

Correlations Among Forecast Errors for Credit Spreads[2]

Jan. 1992 to Jul. 1998

	EM	*SW*	*AA*	*HY*
EM	1			
SW	0.177	1		
AA	-0.042	-0.061	1	
HY	-0.001	0.017	0.627	1

Dec. 1994 to May 1995

	EM	*SW*	*AA*	*HY*
EM	1			
SW	-0.101	1		
AA	-0.181	-0.136	1	
HY	-0.163	0.110	0.727	1

Oct. 1997 to Mar. 1998

	EM	*SW*	*AA*	*HY*
EM	1			
SW	0.623	1		
AA	0.410	0.430	1	
HY	0.630	0.607	0.682	1

Aug. 1998 to Feb. 1999

	EM	*SW*	*AA*	*HY*
EM	1			
SW	0.669	1		
AA	0.103	0.116	1	
HY	0.404	0.476	0.586	1

[2]Correlations among one-period ahead forecast errors for the different credit spreads.

EM – Emerging Market Bond Index spread;
SW – U.S. dollar 10-year swap spread;
AA – AA corporate bond spread;
HY – High yield bond index spread.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 5, 1999

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY SUMMERS

FROM: Edwin M. Truman EMT
Assistant Secretary for International Affairs

SUBJECT: Risks in the International Economy and External Vulnerabilities of the U.S. Economy

The risk of a global recession and an international financial meltdown - that emerged in 1998 after the collapse of Russia and the ensuing bout of global contagion - has receded. The current prospects for world economic growth in 1999 and beyond appear brighter than at the turn of the year. However, the world economy and financial system still face significant vulnerabilities and risks that have to be monitored and addressed in the interests of the U.S. economy. This memo describes such risks and suggests some policy responses. There are three broad areas of concern in the international arena:

1. Some emerging market economies of systemic significance may experience a financial and economic crisis that could spread to other emerging markets and to the U.S. and world economy.
2. The United States economy and its financial markets face potential vulnerabilities from our external position. These include: the sustainability of our growing current account position; the risks deriving from a sudden sharp weakening of the dollar; the uncertain growth developments in the rest of the world; and the potential impacts of such external factors on the stock market and domestic growth.
3. The Y2K problem poses potential risks for the liquidity of the international financial system and the world business cycle.

1. Risks of Financial Crisis in Emerging Market Economies

Some emerging market economies of systemic significance may experience a financial and economic crisis with the risk that financial contagion to other emerging markets may occur, as in 1998. We focus on three groups of countries:

a. Large emerging market economies that would have a systemic impact on global financial conditions if they were to experience a crisis. Argentina and China at this point appear to be the most vulnerable among this group.
b. Other large emerging market economies that are potentially fragile and thus may face problems with systemic implications: Brazil, Mexico, Russia, Korea, Indonesia, and Turkey.
c. Financially fragile smaller economies that may be trigger a broader financial crisis, for example, Ecuador, Colombia, Venezuela, Romania, and Ukraine.

a. Large Potential Crisis Economies

Argentina

Problem and Risk:

Argentina has been recently buffeted by a series of severe external shocks. The global contagion of 1998 led to a sharp increase in its sovereign spread and a reduction in the availability of private international financing; the sharp fall in commodity prices hurt the country's terms of trade and exports; and the devaluation and recession in Brazil worsened the external balance.

All these shocks have taken a toll on Argentina, where the straitjacket of a currency board does not allow monetary autonomy (and exchange rate adjustment) and where a small financial system leaves little room for domestic financing of a fiscal expansion.

The economy is currently in a severe recession and the prospects for early recovery are dim. As the recession continues, the build-up in non-performing loans will weaken the banking sector. The recession, the large burden of external debt (very high relative to exports (449%) due to the small traded sector (11.6% of GDP)), a real appreciation in trade-weighted terms that has led to a loss in competitiveness, and the uncertainty about the future course of economic policy following the presidential election in October have led to nervousness in domestic and international financial markets. The ensuing sharp increase in dollar and peso denominated interest rates has worsened the economic contraction and the country's ability to finance its fiscal and external imbalance.

The risk of a speculative attack on the currency, a sharp loss of confidence by investors, and an ensuing financial crisis is growing in part because there are legitimate doubts about the long term viability of the current exchange rate regime.

Proposed response:

In the short-term (until the October election), the authorities should ride out the financial pressures by maintaining fiscal discipline, and should pass a proposed law to help ensure continued declines in the fiscal deficit over the medium-term.

The U.S. should keep in close contact with the Argentine authorities and support a beefed-up IMF program of precautionary financing. Such a program could rely on alternative IMF facilities: either an augmented precautionary EFF program such as the one that Argentina is currently following, or an application for the new Contingent Credit Line (CCL) designed to provide precautionary financing to countries with sound fundamentals that are buffeted by international contagion. The IMF has, however, expressed some tentative concerns about whether Argentina would qualify for a CCL.

In the medium term, Argentina will have to consider whether to proceed with dollarization, and the U.S. will need to consider whether and under which conditions it would support such dollarization.

Regardless of whether Argentina proceeds with dollarization or maintains its current system, the Argentine authorities will have to address the competitiveness problem through reforms that make labor markets and nominal wages more flexible and micro reforms that increase the long-run growth rate of productivity. While the management of public debt has been reasonably sound, as maturities have been lengthened, the country will also need to further tighten fiscal policy to provide a cushion against future market turbulence to generate a long run decline in the relatively high level of domestic and external public debt.

China

Problem and Risk:

The recent slowdown in economic growth and contraction of exports in China is a source of serious risk and increased vulnerability. China's exports have declined by 4.6% over the first six months of 1999 compared with 1998 and its trade surplus has shrunk by 64.5% over the same period. The ambitious program of medium term economic reforms pursued by Premier Zhu -- continued economic liberalization, phase-down of unprofitable state-owned enterprises, clean-up of a distressed financial institutions, trade liberalization and WTO accession -- was politically conditioned on economic growth remaining high and exports growing at sustained rates.

The slowdown of economic growth has raised fears of unemployment and social instability and could lead to reluctance by the Chinese authorities to aggressively pursue reforms. In addition, slower growth, persistent deflation and sluggish exports have increased the pressure on the government to change its exchange rate policy and to consider a devaluation.

Large sections of the financial system are under serious financial distress as non-performing loans are increasing and many banks and financial institutions are effectively insolvent. The implicit liabilities for the government deriving from the likely eventual bail-out of the financial system are large and growing; they add future fiscal burdens to a fragile fiscal situation where actual fiscal deficits are even larger than what is revealed in official figures. The true deficit is close to 10% of GDP.

Foreign reserves are rising very slowly and capital controls have been tightened to stem capital flight, which had accelerated last year.

The medium-term sustainability of the current exchange rate regime, a de facto currency peg, is in doubt. While the risk that a speculative attack may force a devaluation is small, given capital controls and high reported reserves, economic considerations may eventually lead to a change in policy.

A mismanaged devaluation, in a regional environment that is still fragile and where political and military tensions are mounting, may have the potential to create serious contagion effects. The risks of such contagion are not as high as last summer, when a yuan devaluation would have put severe pressures on the Hong Kong peg and would have led to another round of devaluations in the Asian region, but the risks of a mismanaged devaluation are real. Although China does not have an overall large amount of foreign currency liabilities, a devaluation may lead to financial distress in the non-trade sectors and among those firms and financial institutions that have significant foreign currency liabilities.

Proposed response:

In the short-run, the United States should not rigidly lock China into maintaining a particular exchange rate regime.

It should be China's choice whether and when to change its policy, and we should engage them in a dialogue on their choice of currency regime if they wish, which is unlikely. (In China's latest Article IV consultation with the IMF, the staff encouraged the Chinese authorities to consider a move toward a more flexible exchange rate policy over the longer-term.)

For the medium term, we should continue to emphasize the need for sustained market-oriented economic reforms, including an early decisive clean-up of the financial system, a down-sizing of the inefficient state-owned enterprise sector and a strong support of a WTO accession by China on commercially viable terms.

b. Other Large Economies at Possible Risk

Brazil: Absent full implementation of the medium-term fiscal reforms in last year's fiscal package and a rapid government response to any judicial setbacks on the package's tax measures, Brazil is not yet on a sustainable fiscal path and the current stabilization plan may fail.

Mexico: The financial outlook is good heading into the 2000 presidential election, but political uncertainties surrounding what may be a truly democratic transition present risks for the exchange rate and the economy given the country's past history of election cycle currency crises.

Russia: Political constraints and election jockeying may affect the incentives to implement a modest program of stabilization and reform.

Korea: The political momentum for corporate and bank restructuring is fading given the strong economic recovery. However, the financial collapse of Daewoo may affect the recovery of Korea. A failure to restructure Daewoo properly may seriously undermine economic and political reform in Korea.

Indonesia: Presidential election uncertainty and related uncertainty about the economic policies of the new administration may negatively affect prospects for economic recovery in an environment in which financial and corporate restructuring is lagging.

Turkey: A history of high inflation and a precarious international financial situation, combined with high domestic real interest rates and an unstable political situation, raise concern about the Turkish authorities' ability to maintain macroeconomic stability. Efforts to put together a stabilization program could well be too little too late.

2. Vulnerabilities from the External Sector
Problem and Risk: Vulnerability to "Hard Landing" Scenarios

Four interrelated macroeconomic developments pose potential threats to the U.S. economy:

- the growing trade and current account deficit may become unsustainable and require a sharp adjustment,
- the dollar may experience a sudden and sharp weakening,
- the stock market may suddenly crash, and
- growth developments in the rest of the world may be unfavorable to the U.S..

While each of these developments may have potential beneficial effects, it may also be a source of serious disruption to the U.S. economy in the short run. Four risky "hard landing" scenarios, each triggered by one of these developments could become a matter for concern.

Each one could involve a scenario where the movements of asset prices and real economic quantities may become excessive. Regardless of the source of the shock, in each scenario the dollar could overshoot, the stock market could fall too far too fast, and the bond market may also experience a sharp contraction. This generalized asset deflation may turn a desired "soft-landing" of the U.S. economy into a "hard landing/crash" with systemic risks of a globalized recession.

a. **An unsustainable current account deficit**

The current account deficit is large ($221 billion or 2.6% of GDP in 1998) and forecast to widen further in 1999 (to $331 billion or 3.7% of GDP) and to continue to widen in the foreseeable future. This worsening of the current account deficit could trigger a sharp and sudden fall in the value of the dollar.

Although such a depreciation of the dollar would, over time, improve the trade deficit, it may also cause unwelcome economic and financial effects in the short run. Investors may dump U.S. assets (equities and bonds) leading to a crash of the stock market and an increase in long-term interest rates. As a result, the U.S. economy may cool, but a recession could ensue.

Protectionist pressures around the world and in the United States (and threats of trade wars) could trigger or exacerbate these developments, reduce investors' willingness to finance our deficit and trigger a sharp dollar downturn that may have the nefarious consequences described above.

b. A sharp depreciation of the dollar

The reversal in the flight to quality and/or sudden shifts in investors' expectations and appetite for U.S. assets may trigger a sharp contraction in the value of the dollar.

This could, in due course, be beneficial for the current account, but a sharp and sudden depreciation of the dollar may also spark panic about capital losses on U.S. assets and concerns about inflation.

A rapid fall of the dollar could cause a sharp fall in the stock and bond markets with further negative feedbacks on the currency value.

A domestic and global recession could be the eventual outcome.

c. A sharp and rapid fall in the stock market

Although a gradual leveling off of the stock market could aid the cooling off of the U.S. economy, a sharp sudden crash in the stock market could have serious consequences.

Domestically, wealth and confidence effects may lead to a rapid fall in domestic demand (consumption and investment) triggering a recession.

The stock market contraction would likely lead to a selloff of the dollar. Although the slowdown of the economy and the weaker dollar would improve the current account over time, an excessive sharp depreciation of the dollar may have serious near term economic and financial consequences. It may make it more difficult for the Federal Reserve to make the best policy choice.

d. **Faster economic growth in the rest of the world**

Although a recovery in world economic growth will be beneficial as it will induce an improvement in the U.S. current account, it may also present some risks.

Economic recovery in Japan, more sustained growth in Europe, and faster global growth among emerging and industrialized countries will put downward pressure on the dollar as it might lead to expectation of increasing interest rates in the rest of the world and increase the relative attractiveness of investments in those economies, as we may have seen in recent weeks.

An economic recovery in Japan and Europe may also lead to greater current account deficits in emerging markets, thus inducing competition for scarce world savings and causing the reversal of the flight to quality that supported the recent financing of the growing U.S. current account deficits. Thus, higher world growth may weaken the dollar and make it more difficult to attract net capital inflows at unchanged interest and exchange rates. The negative effects may set off a sharp contraction in U.S. asset prices (stock and bond prices), a contraction in U.S. economic activity and, possibly, a global downturn.

Proposed policy response:

The likelihood of a four crash scenario is not large, but careful management of our policies will be required to insure an outcome where U.S. growth slows to a sustainable rate, world growth picks up, the current account improves over time (perhaps associated with a modest and gradual depreciation of the dollar), and the stock market is part of a slowdown in the growth of domestic demand as part of a process that leads to a needed improvement in the external balance.

In this context, we should:

- maintain our strong-dollar policy and counter any perception of deviation from it. We should be prepared to intervene in foreign exchange markets as appropriate.
- focus on our fundamentals: maintain sound fiscal policies and avoid fiscal actions that reduce national savings; implement policies that boost private savings; and follow policies that support high growth rates of productivity
- continue to push for domestic-demand led growth in Japan and Europe and for the pursuit of sound economic policies and reforms around the world
- avoid protectionist pressures at home while seeking broad-based trade liberalization and market opening abroad
- respond to severe systemic shocks that may cause a global liquidity crisis by supporting easier monetary policies among G7 countries; IMF programs for emerging market economies in distress, and in extremis being prepared to consider an increase in world liquidity via a special SDR allocation.

3. Global macroeconomic implications of the Y2K problem

Problem and Risk:

- Everyone is aware of the nature of the problem and different countries are at different levels of preparedness in addressing it. The direct risk of a meltdown in financial markets is negligible as financial institutions in the U.S. and in major countries abroad are well prepared for the Y2K problem.

A bigger risk may be that economic agents' and investors' overpreparedness may cause undesirable economic and financial repercussions. The risks are here twofold:

- On the real side, over-preparing for Y2K may cause a boom and bust sequence at the turn of the year, due largely to an inventory cycle.
- On the financial side, the investors' potential unwillingness to be exposed to liquidity and credit risks at the turn of the year may cause a shift in the preference toward highly liquid and safe assets (such as U.S. Treasuries). This increase in risk aversion and preference for liquidity may cause a liquidity squeeze and a credit crunch for a broad range of borrowers (especially governments, banks and financial institutions and firms in emerging markets).

The dollar could also be affected to the extent that non-dollar-based investors reduce their claims on largely dollar-based emerging market economies, and instead "repatriate" their holdings to their home country. Moreover, as the U.S. is a net debtor (in terms of stocks and flows), it might face generalized downward pressure on the dollar from Y2K in the uncertainty leading up to the end of the year.

Proposed Policy Response:

Although it may be too late for most countries to address comprehensively the direct effects of Y2K disruptions, the international community can work to minimize the financial implications of the problem. A set of actions that may reduce the risk of a generalized liquidity crisis and excessive real side boom/bust cycle could include:

- an IMF overdraft facility that provides transitory lending of liquidity between December 1999 and January 2000 to minimize the risk of a global liquidity squeeze;
- the implementation in other G7 countries and emerging market economies of central bank liquidity facilities modeled along the lines of the facility designed by the U.S. Federal Reserve to address unexpected liquidity shocks that may hit the U.S. financial system at the turn of the year; and
- a willingness by major central banks to ease monetary policies on a temporary basis if evidence of a serious liquidity crunch emerges.

cc: Deputy Secretary Eizenstat
Sheryl Sandberg
Todd Stern
Stephanie Flanders
Tim Geithner
Gary Gensler
Lee Sachs
David Wilcox
Robert Cumby
Neal Wolin
Caroline Atkinson
Nouriel Roubini
Martin Baily (CEA)
Robert Lawrence (CEA)
Douglas Elmendorf (CEA)
Steven Braun (CEA)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

August 16, 1999

MEMORANDUM FOR THE PRESIDENT

FROM: Lawrence H. Summers

SUBJECT: Potential Risks to the Global Economy

One topic we did not have a chance to cover in our August 11 meeting that I wanted to bring to your attention is the deterioration in recent weeks of markets for corporate bonds, interest rate swaps, mortgages and asset-backed securities. Spreads are approaching, and in some cases have surpassed, levels reached during the fall of 1998. For example, the spread of 30-year fixed rate mortgages over 30-year Treasuries was 205 basis points as of last Friday, compared to an average of 110 bps between January 1997 and July 1998. Similarly, the spread of AAA corporate bonds over 30-year Treasuries was 139 bps as of last Friday versus an average of 74 bps between January 1997 and July 1998.

The spread widening appears to result from several factors, including: 1) an acceleration of corporate borrowing for year-end financing (possibly linked to Y2K concerns); 2) a reduction in liquidity resulting from a reduced appetite for risk among market makers; 3) an increase in the use of instruments other than Treasuries as hedging vehicles in the bond markets; and 4) general caution in the domestic debt markets given recent weakness in the dollar and the possibility of the Federal Reserve raising interest rates further.

While these spreads are high, they do not appear to be posing major risks to the financial system at this time. We should be less concerned about the impact this spread movement is having on the financial system than we should be about the impact on the real economy caused by the higher absolute borrowing costs that result from the widening of spreads and an increase in yields on Treasury securities. We will continue to monitor the situation and provide updates as they become necessary.

I am also attaching several articles that I thought would be of interest:

1. An August 13 *Financial Times* article describing this recent widening of spreads and tying it to the underlying question of the sustainability of our current account deficit.

2. A short article by Paul Krugman of MIT outlining his view of the risks to the dollar.

3. An excerpt from a report by Hong Kong Shanghai Banking Corporation (HSBC) on the implications of a possible financial market bubble in the United States.

4. A recent piece by Salomon Smith Barney highlighting current market concerns about emerging markets.

FINANCIAL TIMES FRIDAY AUGUST 13 1999

15

The wobbliest month

Bond markets are under stress and investment banks and hedge funds may be suffering, says **John Plender**

For the third year in succession August is proving to be a month of extreme financial turbulence. The US equity and bond markets have been nervous. The dollar looks distinctly tired after its long bull run. Meanwhile, rumours are rife that at least one investment bank has incurred big losses on its proprietary trading activities.

The trouble is thought to have arisen in the interest rate swaps market, which is going through unprecedented and stressful contortions. Such swaps are the derivative instruments that allow companies and banks to exchange their fixed interest income flows for floating ones, and vice versa.

Last weekend William McDonough, the head of the New York Federal Reserve, felt the need to tell Dow Jones Newswires that he knew of no situation that posed a systemic risk. It was the kind of central banker's denial that offers mixed comfort to nervous investors and traders.

By the middle of this week, conditions in the markets had started to stabilise. Does that mean the scare is already at an end? Probably not, because the behaviour of markets still points to considerable aversion on the part of investors and borrowers to taking on financial risks.

Even after Mr McDonough's statement, spreads on 10-year swaps were higher than at the time of the financial crisis in August 1998. The spread reflects the difference between the fixed rate being swapped and the yield on a benchmark Treasury bond of comparable maturity. Any widening of the spread points to increased concern about the risk of lending money to companies relative to lending it to the US government – regarded as the most creditworthy of borrowers.

This is noteworthy because it was the extreme gyration in swap spreads that helped to inflict such heavy damage on John Meriwether's Long-Term Capital Management, the hedge fund that was rescued by its bank creditors a year ago. To the extent that LTCM and others have stuck to their original strategies in the hope that they would become profitable again in less volatile markets, there is obvious scope for more trouble. That trouble could affect both hedge funds and the proprietary trading desks of investment banks.

Sticking to the original trading strategies would have seemed amply justified as late as June this year. But the market gyrations of the past six weeks could have reversed many of the gains. Indeed, all financial institutions that have based their trading strategies on the assumption that historical relationships in the markets would hold firm are now likely to be facing losses. What is causing the trouble?

The immediate financial pressure reflects concern that the Federal Reserve will shortly raise US interest rates again. Companies are refinancing bank borrowings in the corporate bond market in order to lock in today's low interest rates.

Many are worried that the corporate bond market will become illiquid because of the Y2K millennium computer problem. They have brought forward their borrowing plans. The pressure that arises from such heavy issuance is part of the reason why spreads have widened in relation to the US Treasury market, where the government is now buying back its own debt.

The same pressure is reflected in spreads in the swaps market where corporate treasurers simultaneously hedge interest rate risk in deals related to the bond issue. While corporate demand for bond finance is exceptionally strong, the supply of capital is now affected by a shift in the global economic background, and possibly also in the way the US economy works.

The US economy's ability to grow faster than its underlying potential for long-term growth has depended recently on the continuation of a virtuous circle. The existence of surplus capacity in the much weaker Asian and European economies has imposed benign disinflationary pressure on the US. Surplus liquidity from the weaker economies has also been sucked into the US capital markets, thereby contributing to dollar strength. That has in turn kept import prices in check.

These strong capital inflows have helped finance a stock market and corporate investment boom at a time when US households are spending in excess of their income. So the economy has continued to grow despite a growing current account deficit that reflects the shortfall of domestic savings against investment. Economists such as Tim Congdon of Lombard Street Research and Bill Martin of Phillips & Drew have long argued that these imbalances in the US economy are unsustainable. The difficulty has been to predict precisely when international investors will shy away from financing a current account deficit that is running at $30bn a month.

With the European economies and much of Asia now recovering, the growth of global liquidity is slowing. Moreover, the change in sentiment towards the dollar since mid-July carries a strong hint that global capital flows may be changing direction. Certainly US and European institutional investors have been pouring large sums into the Tokyo market this year. The weakness of the US bond market points to a similar conclusion.

Is a repeat of the financial crisis that followed last year's Russian default under way?

So the widening of credit and swap spreads is a direct reflection of tighter supply and demand conditions in the capital markets. The question is whether a repeat of the financial crisis that followed last year's Russian default is under way. The present credit crunch is clearly less severe. Big companies are still

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able to raise funds in the bond market – at a price. Nor are spreads in the US Treasury market widening as they did in 1998 to reflect fractional differences in liquidity between bonds.

Yet the markets have a very fragile feel. And if a shift in the pattern of global capital flows is indeed under way, the scope for shocks will increase. One potential horror story concerns the currency markets. As Paul Krugman, the US economist, has pointed out, a weak dollar would lead to economic contraction almost everywhere. This is because currency depreciation prompts a positive demand shock in the US and a negative supply shock for the country concerned.

That is to say, US goods would become more competitive around the world, thereby increasing demand in an economy where demand already outstrips supply. At the same time a devaluation-induced increase in import prices would further constrain supply that already falls short of demand. With the US economy operating with no slack at all, a sudden dollar decline would lead to a wage-price spiral, which would probably force the Fed to raise interest rates.

For the rest of the world, which still suffers from weak demand and is only now beginning to recover from an economic setback, currency appreciation would have an equal and opposite effect. It would no longer be possible to rely on the US as the global spender of last resort. Yet the ability to respond to a falling dollar by reducing interest rates is limited in Europe and more especially Japan, where short-term interest rates are close to zero.

A changing pattern of capital flows also poses a threat to heady valuations in US equities. For as Brian Reading, the economist, argues, there are intriguing parallels with 1987. The crash of October that year, the worst since 1929, is thought to have been partly caused by rising interest rates around the world, and a row between James Baker, the then Treasury secretary, and the Germans after a Bundesbank rate increase. Mr Baker was worried that the Germans were reneging on their obligation under the 1987 Louvre Accord to support the dollar when the current account deficit on the US balance of payments was approaching 4 per cent of gross domestic product.

Mr Reading says the role of the Japanese, though largely ignored at the time, was important. On the eve of the crash, the Japanese Ministry of Finance was arm-twisting domestic financial institutions into buying $40bn-worth of privatisation shares in Nippon Telephone and Telegraph at an astonishing multiple of 300 times earnings. As a result, the flow of portfolio capital to the US from the world's biggest creditor country dried up. The recent intervention to curb the appreciation of the yen carries an interesting echo of the Louvre interventions. There are equally suggestive parallels in today's weakening bond markets and rising interest rates, accompanied by a deteriorating US current account.

Of course, when the US equity market finally collapsed in October 1987, it was none other than Alan Greenspan, the Fed chairman, who came to the rescue. Confronted with a shock that threatened the financial system, he opened the monetary sluice gates, as he did in the crisis last autumn. Can the markets rely on Greenspan coming to the rescue yet again if the collapse of a big institution poses a systemic threat or the markets take a severe tumble?

It would certainly be harder for him to do so. Last year, the threat of deflation was sufficiently real to justify a significant loosening of policy. This year, the economy is still growing strongly, labour market conditions have tightened and the dollar has weakened. The threat of inflation is more potent, which means that the central bank faces a larger dilemma.

The economy is no doubt sufficiently robust to survive a fair measure of financial turbulence. Mr Greenspan must also be concerned that moral hazard – the belief that the Fed is putting a safety net under the market following last year's 0.75 per cent crisis cut in interest rates – is contributing to high valuations on Wall Street.

But much will depend on the scale of any problem. Stephen Lewis, chief economist of London-based Monument Derivatives, argues powerfully that the Fed cannot allow historically high swap rates to deter it from tightening credit. Otherwise it would undermine confidence in the anti-inflationary thrust of Fed policy.

Yet a full-blown stock market collapse might be another matter. Mr Lewis also forecasts a very interesting month. He could well be right.

A DOLLAR CRISIS? by Paul Krugman, August 1999

Time does fly. A year ago Asian currencies were plunging, hedge funds were attacking, and the world seemed on the brink of crisis. Now Asian currencies are if anything too strong, it's the dollar that's under pressure - and the world is, possibly, on the brink of another crisis.

Is all the buzz - from investment newsletters, the Medley Report, and so on - about a looming dollar crisis justified? The truth is, I don't know: while the dollar is surely overvalued on any "sustainability" calculation (see below), so is the stock market, and *that* bubble has gone on for a very long time. But people in Washington are reported to be worrying about the subject (although the Medley Report's statement that there is a formal working group turns out to be untrue), so some outside kibitzing seems to be in order.

Let's run through four questions:

1. Why should we believe that the dollar is overvalued, and hence due for a fall?

2. Why might a dollar decline turn into a dollar plunge?

3. Why would that be a bad thing?

4. What should be done about it?

1. *Is the dollar overvalued*?

The basic reason for believing that the dollar is overvalued is, of course, that the United States is running very large current account deficits, and that the possessors of other major currencies - especially the yen - are correspondingly running large current surpluses.

Now current account imbalances are not necessarily a warning sign. Indeed, they are the necessary counterpart of any transfer of funds from places with excess saving (Japan) to places with high returns on investment (the U.S.). Still, massive current account imbalances mean that the surplus countries are holding an ever growing share of their wealth in the deficit countries, a process that cannot go on forever; and (Herbert) Stein's Law reminds us that things that cannot go on forever, don't. Eventually the U.S. deficit and the rest-of-world surplus must be sharply reduced, perhaps even reversed; and while this adjustment could take place in other ways, it is likely that much of it will occur via a decline in the value of the dollar vis-a-vis the yen, the euro, and so on.

The "sustainability" question - which as far as I know I first posed back in 1985, in a paper titled "Is the strong dollar sustainable?" - is whether the market seems to be properly allowing for that required future currency decline. If not, the dollar is doing a Wile E. Coyote, and is destined to plunge as soon as investors take a hard look at the numbers. (For those without a proper cultural education, Mr. Coyote was the hapless pursuer in the Road Runner cartoons. He had the habit of running five or six steps horizontally off the edge of a cliff before looking down, realizing there was nothing but air beneath, and only then plunging suddenly to the ground).

And the numbers do have a definitely Coyoteish feel. True, interest rates in the United States are higher than those in Japan or Europe, which means that the market is in effect predicting gradual dollar decline. But inflation is also a bit higher in the United States; the real interest differential on long-term bonds is probably only about 2 percent vis-a-vis Japan, less vis-a-vis Europe. Thus investors are implicitly expecting only a 2 percent per annum real depreciation of the dollar against the yen over the long term; given the size of the current account imbalance, that just isn't enough. Beep beep!

2. *A dollar plunge?*

There are, then, good reasons to expect a dollar decline, perhaps even a sharp drop as markets start to pay attention to trade numbers again. Remember that in 1985, when the U.S. current account deficit was about the same share of GDP as it is today, a revision of market perceptions caused a drop from 240 to 140 yen, from 3.3 to 1.8 Deutsche marks.

But there is also a new element, which could amplify dollar decline, and cause a truly dramatic plunge: balance-sheet domino effects. According to people who ought to know, the "carry trade" that did so much to drive exchange rates last fall is back in force: a relatively small group of highly leveraged investors have borrowed in yen (and euros? the gossip is less clear) and invested the proceeds in higher-interest dollar assets. Should the dollar fall sharply, they will suffer losses - which will force them to contract their balance sheets, selling dollars, and driving the currency lower still, in what could be a massive overshoot.

Now Rube Goldberg effects - mechanical linkages via balance sheets, producing predictable mispricing - aren't supposed to happen in an efficient financial market. Efficient markets theory would tell us that in the face of an excessive depreciation of the dollar investors would recognize the long-term profit opportunity and buy greenbacks en masse - long-sighted Buffetts compensating for the balance-sheet problems of the hedge funds. Well, maybe - but maybe not.

3. *Who cares?*

Currencies rise, currencies fall. Isn't it a zero-sum game, and for that matter aren't the stakes pretty small in any case?

In general, yes. And even if we are now facing an unsustainable dollar overvaluation comparable to that of early 1985, those old enough recall that despite grim warnings of an impending "hard landing", the correction of that overvaluation was almost entirely benign. (Yes, some claim that it led indirectly to Japan's bubble economy - but that is a complicated story).

But matters are a bit different now, because we start from a different place. Arguably, the state of the world economy right now is such that a sharp dollar decline would be contractionary almost everywhere (except Argentina and Hong Kong).

To understand why, bear in mind that a currency depreciation (or, more strictly, a revision of expectations leading to a currency depreciation - the exchange rate is, of course, an endogenous variable) constitutes a positive demand shock and a negative supply shock to the depreciated country. It is a positive demand shock because the country's goods become more competitive on world markets; it is a negative supply shock because import prices increase. And conversely, of course, a currency *appreciation* is a negative demand shock and a positive supply shock.

The reason to be concerned about a sudden dollar decline, then, is that it so happens that the United States is currently a supply-constrained economy, while much of the rest of the world is demand-constrained. So the net effect is negative almost everywhere.

In the United States, where wages are finally beginning to reflect a more-than-full-employment labor market, a sudden dollar decline would at least threaten to produce a wage-price spiral - and the mere threat would mean that the Fed would likely be forced to raise rates. Whether this would lead to a substantial contraction is unclear - who the heck understands aggregate supply behavior these days? - but a dollar decline is certainly not positive for the U.S. right now.

As for the rest of the world, demand shocks from a currency appreciation are normally easy to deal with: just cut interest rates, which among other things limits the appreciation. But of course Japan is firmly in a liquidity trap, and cannot cut rates; the euro-zone is not in a liquidity trap, but a sufficiently sharp dollar decline could put it into one. The only places that clearly benefit from a weaker dollar are demand-constrained economies pegged to the dollar; and Argentina and Hong Kong are just not big enough to change the general picture.

Simple textbook open-economy macroeconomics, then, tells us that starting from where we are right now - a U.S. economy at or beyond capacity, a large part of the rest of the world well below capacity, and in or near a liquidity trap - a drop in the dollar will be a global contractionary force. How strong a force? Well, it depends on the drop; if markets were to force the U.S. to move rapidly to current account balance or beyond, the numbers would be very troubling. This is unlikely, I think; but then serious crises usually are, *ex ante*.

4. *What is to be done*?

Can the disturbing scenario just sketched out be prevented?

The U.S. cannot, of course, relax its supply constraint. We've already had a virtual miracle in our ability to expand this far before inflation started to appear; it's not just silly but greedy to ask for another.

Can intervention stabilize the dollar? If it is sterilized, or more generally if it is not backed by some fundamental change in policies, the answer is probably not. Intervention can sometimes turn around a market panic, but it cannot sustain the unsustainable. Look at the issue from Japan's side: as I argued repeatedly last year, a liquidity-trap economy faces the persistent problem that it cannot get its currency weak enough, because even at a zero nominal interest rate its real rate is too high. You wouldn't expect sterilized intervention - or any intervention that does not change expectations about Japanese inflation - to work; and it won't.

What *will* work is radical monetary expansion in the demand-constrained economies - Japan definitely, maybe also Europe if necessary. I don't think I need to go through the logic again - it's all there in <u>Japan: Still trapped</u> . But note that monetization will not only expand domestic demand, but help to limit the dollar's fall (and relax the "sustainability" constraint by increasing demand for U.S. exports). These are the same effects that would flow from interest rate cuts in the appreciating countries under normal circumstances.

And that is the main point. The last time we had a seriously overvalued dollar, the inevitable correction did little harm, mainly because the appreciating countries were easily able to expand domestic demand. If the current situation looks more troubling, it is because non-dollar countries cannot increase demand using conventional policies, and are unwilling to contemplate unconventional policies. That unwillingness, not the dollar per se, is the source of the problem.

July 1999

Economics

Bubble trouble

Global

Bubbles past and present and what happens if the US bubble bursts

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Bubble indicators and bubble reality

- Even with the advent of low inflation, financial market bubbles can provide a significant threat to economic stability, with booms typically followed by subsequent busts We examine a number of previous bubbles to derive a set of bubble indicators. These indicators suggest that the US productivity miracle of recent years has now given way to a financial market bubble, fuelling an economic boom. Good news on growth in the short term is likely to be replaced by declining asset prices by the end of this year and, possibly, a recession by 2001.
- Although welcome, the ongoing high-tech revolution is reminiscent of the production and communication breakthroughs of the 1920s - genuine improvements in productivity which, nevertheless, gave way to excessive equity valuations. The deteriorating US current account position is a classic indicator of bubble economies as are strong domestic money supply growth and heightened inflows of capital from abroad - a legacy of the Asian crisis.
- We show that the recent period of strong growth in the US, accompanied by an absence of inflationary pressures, is again a phenomenon associated with past bubbles. The combination, although good news in the short term, seduces investors into believing in permanent "new paradigms". These beliefs normally end in tears. Inflation may be low, but excess demand pressures typically still trigger an interest rate response. Moreover, excessive focus on the pursuit of inflation targets may *increase* the danger of financial bubbles.

The aftermath of a US bubble

- The US bubble is likely to burst through a combination of rising interest rates and a falling dollar. We see both coming through in the second half of this year, suggesting a significant risk of a sharp and sustained fall in asset prices towards the end of the year and in the first half of 2000.
- This combination is likely to deliver a slowdown in growth through 2000 and raises the risk of outright recession in 2001. The rest of the world will not be immune. Falling US equity prices and a weaker dollar will create new problems for both Japan and Euroland, increasing the dangers of outright global recession.

"The strength and durability of the economic upswing has now exceeded all post-war records.....This performance compares favourably not only with our own past, but also with the economic performance of other countries....The plain fact is that the British economy has been transformed. Prudent fiscal policies have given business and industry the confidence to expand, while supply side reforms have gradually removed the barriers to enterprise."

Nigel Lawson, Budget Speech, 15 March 1988

"What Japanese investors have become aware of is the dramatic way Japan's blue-chip companies have changed the sources of their earnings through restructuring. This has made their profits too erratic to give any meaning to rigid measures such as a p/e ratio. Instead investors have started to assess a company's future stream of earnings by looking at the total value of a firm's assets.........The implication is that shares may be underpriced."

The Economist, 15 April 1989

"...the fundamental underpinnings of the recent US economic performance are strong. Flexible labour markets and the shift to surplus on the books of the federal government are facilitating the build up in cutting edge capital stock.....The new technologies and the optimism of consumers and investors are supporting asset prices and sustaining spending."

Alan Greenspan, Humphrey-Hawkins Testimony, 24 February 1999

Summarising bubbles

- Financial market bubbles provide one of the greatest risks to economic performance. They contribute to booms in the short term which often give way to subsequent busts. They are difficult to spot and are often confused with productivity miracles. They lead to huge errors in terms of resource allocation. Countries can sometimes take years to recover after a bubble bursts.

- This paper is an attempt to provide some guidance on the development of financial market bubbles. It is divided up into nine main sections. After a short introduction, we look at typical developments during bubble periods (page 10) and assemble a bubbles checklist (page 27). We then examine when bubbles burst (page 28). We assess the real costs of bubbles (page 32) and look at evidence for bubbles today (page 37). All arguments support the idea of a US bubble now and, as a result, we map out a scenario for a bursting of this bubble (page 44). We conclude by suggesting that inflation targets may increase the risk of financial market bubbles (page 51).

- Our analysis of previous bubbles focuses on four countries - Japan, the UK, Spain and Mexico. We find a number of similarities which enable us to construct a bubbles "checklist" which expands the results from our four case studies to cover other countries which have also suffered from bubbles.

- We are able to debunk some common myths regarding enhanced productivity performance. We show, for example, that most bubbles develop during a period of above average growth and below average inflation. Although an ideal combination, we show that these periods are typically unsustainable, giving rise to current account problems and, more often than not, an interest rate response which brings growth expectations back to reality with a bang.

- The association of bubbles with low inflation is an odd result. After all, bubbles are typically a financial phenomenon associated with rapid growth of domestic money supply and, more often than not, substantial inflows of liquidity from abroad as investors attempt to buy into a supposed new paradigm. However, we show that bubbles often are helped along by declines in global commodity prices or strong exchange rates, both of which tend to restrain inflationary pressures in the short term.

- We also show that bubbles tend to develop because policy makers are unusually happy to disregard potentially worrying indicators of excess domestic demand. Prime examples of this approach are the Japanese attempts to reduce the current account surplus in the late 1980s, UK attempts to follow a DM3.00 policy in the late 1980s and, more recently, the Fed's decision to lower interest rates in September and October of last year.

- Our HSBC bubbles checklist shows a consistent pattern among our four case studies together with other previous bubble examples - including

Summarising bubbles

Sweden, Norway, Finland and Thailand. The checklist also strongly supports our conclusion that the US is now facing a similar bubble experience.

- Bubbles typically burst after a series of official interest rate increases. One increase alone is not normally enough to do the trick. Only when markets are persuaded both that there has been a permanent increase in the discount rate to be applied to future earnings growth and that earnings growth itself is likely to weaken are asset prices likely to fall aggressively. In other words, central banks have to do enough to persuade markets that the party is over and this typically implies a sustained period of monetary tightening.
- Exceptions to this rule are those countries who have benefited from abnormally high capital inflows from abroad, perhaps as a result of very low returns elsewhere in the world. Mexico's bubble, for example, was partly the result of very low US interest rates in the early 1990s. A sudden increase in returns elsewhere can have an effect similar to a series of domestic interest rate increases. Mexico's 1994 crisis was triggered by this process and it is possible that the US now is vulnerable to the same threat, as recovery gathers pace elsewhere in the world.
- Current US performance is in line with previous bubble examples. Virtually all of the indicators on the bubbles checklist are flashing red for the US. Although there may be a productivity miracle, it is unlikely to be sufficient to account fully for the exceptional GDP growth rates achieved in recent years. As with previous bubble examples, actual long term gains in productivity are likely to be much smaller than is currently being claimed.
- Yet the continued gains in equity prices and the private sector liabilities built up alongside them - reflected in the widening current account deficit - are probably based on faith in an ongoing productivity miracle. Reality, however, is likely to be less favourable. Strong growth in money supply, a rapidly rising investment share within GDP, a widening current account deficit and a personal sector spiralling into deficit are all classic indicators of a domestic bubble.
- The bubble will prompt interest rate increases from the Fed. As with previous bubble examples, these rate increases are more likely to reflect worries about future inflation than about existing price increases. Monetary tightening will, in turn, threaten the resilience of the domestic stock market and a substantial correction is now likely by the first half of 2000.
- On this basis, the risks of an ultimate hard landing have substantially increased. When bubbles burst, soft landings never seem to be within reach. Although the short term outlook for the US economy remains rosy, the risks of recession in 2001, both in the US and through the rest of the world, have grown significantly.

SALOMON SMITH BARNEY

FOREIGN
EXCHANGE
RESEARCH

Emerging Markets

10 August 1999

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Emerging World

- **Market concerns over a possible Chinese renminbi devaluation dictate further volatility for the NDFs. But there are good reasons why devaluation may not be imminent, and uncertainty is likely to linger into 2000**

- **The impact of any change in the value of the renminbi on other regional Asian currencies would depend on the timing and magnitude. However the HKD peg is expected to be maintained**

- **Low agricultural commodity prices and the prospect of higher US interest rates mean an adverse external environment for Argentina, though a weaker US dollar internationally is more helpful**

- **The Czech authorities seek a weaker koruna. But achieving that objective will not be easy**

Overview

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- **Doubts over China exchange rate policy are likely to persist into next year**
- **The Hong Kong dollar peg should hold, irrespective of what happens to the CNY — however, further interest rate volatility is assured**
- **Argentina peg to hold. Weaker US dollar will be welcome**
- **Watch for further interest rate cuts in Brazil**
- **Expect positive fundamentals to lower the risk premium for Turkey**
- **Czech National Bank ambitions for a weaker Czech koruna might be frustrated**

Increased concerns over a possible **Chinese renminbi devaluation** have been most recently manifest in major spikes in implied non-deliverable forward (NDF) yields. Fuelled also by a major deterioration in relations with Taiwan, one-year NDFs hit an early August peak of just under 20% in the one year tenor, thus discounting sizeable devaluation. The Chinese authorities are under pressure to stimulate private domestic demand, with major fiscal stimulus and successive cuts in interest rates yet to have the desired effect. Currency devaluation remains the one major stimulatory weapon left in the armoury.

In our opinion, there are several reasons why renminbi devaluation may not yet be imminent. First, aspirations towards WTO membership remain. Second, devaluation would be untimely in the run-up to the fiftieth anniversary of the founding of the PRC on 1 October. Third, fiscal and monetary stimulus measures are probably not yet exhausted. Fourth, devaluation now would come at a bad time for Hong Kong which is battling still to re-establish positive growth post a succession of recent crises of confidence. Fifth, wider regional economic recovery may not yet be sufficient to ward off the threat of competitiveness nullifying depreciation. Sixth, the stronger Japanese yen may draw some more of the immediate sting out of devaluation concerns.

All the above said, there are clearer signs over recent weeks of a more open policy debate within China over the virtues of a more flexible exchange rate policy which may be part of a prolonged period of 'expectations management' on the part of the authorities.

We are comfortable with the view that there is no intention in Beijing to undermine the Hong Kong dollar peg, even in the event of a renminbi devaluation. To do so would be to damage irretrievably Hong Kong's status as an international financial centre. However CNY devaluation concerns, the intensely complex geopolitical tensions with Taiwan, as well as higher US interest rates, all mean higher Hong Kong dollar interest rates at precisely the time when economic fundamentals are demanding stable to lower rates.

In Latin America, we maintain the view that the **convertibility plan in Argentina** will endure. However the external environment remains a challenging one, given downward pressure on agricultural commodity prices, the government's counter-cyclical policies, and the prospect of a further rise in US interest rates. The recent weakening of the US dollar on international foreign exchange markets will be of some relief to Buenos Aires. While the furore over election candidate Duhalde's debt forgiveness remarks has passed, further populist rhetoric is possible ahead of the hotly contested late October presidential election.

Mexican peso economic fundamentals remain supportive. However market attention will gradually shift to prospects for next year's presidential election. In this context, the upcoming 2000 budget debate is likely to be lively.

Adherence to a floating exchange rate has allowed the **Brazilian authorities** the luxury of continuing to cut local currency interest rates. We look for further marked declines by calendar year end at the expense perhaps of further currency volatility. Stronger-than-expected growth and low inflation provide a strong fundamental underpinning for financial markets, though more durable international confidence will be dependent on President Cardoso's ability to regain political popularity and to drive through more stringent fiscal reform measures.

Resistance to excessive currency strength has been a prominent feature of currency markets over recent months. Bank of Japan is fighting a losing battle, while Bank of Korea has played a much stronger intervention hand. Now, the **Czech National Bank** has expressed a desire to see a weaker koruna over the next few months. We believe that this may prove difficult to achieve given the probability of strong privatisation related capital inflows later this year, and a dwindling current account deficit.

Improving fundamentals justify a progressively lower risk premium on **Turkish** local currency interest rates. Ankara is moving towards concluding a deal with the IMF later this year, the domestic political environment is relatively stable, and the current account is improving. Also, despite a disappointing July number and the threat of higher oil prices, inflation expectations are, at last, in decline. Fiscal policy though remains a major area for policy vigilance.

1999-SE-009438

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THE DEPUTY SECRETARY OF THE TREASURY

WASHINGTON

INFORMATION

July 30, 1999

MEMORANDUM FOR THE PRESIDENT

FROM: Stuart E. Eizenstat

SUBJECT: Update on Global Markets
The Week Ending July 30, 1999

Global markets were again this week dominated by the impact of potential increases in U.S. interest rates, moves in major currencies, ongoing uncertainties in several Latin economies, and continued concerns about a possible Chinese devaluation.

- Market expectations of higher U.S. interest rates increased following Chairman Greenspan's Humphrey-Hawkins testimony and higher-than-expected U.S. Q2 employment costs. The resulting decline in U.S. stock and bond markets fed through to markets overseas, but currency and dollar spreads were relatively stable in emerging markets.

- The *euro* and *yen* appreciated moderately further this week, rising to their highest levels versus the dollar since mid-May and mid-February respectively. There appears to be a growing perception among market analysts that the dollar could face significant downside risks. The *euro* continues to receive support from growing evidence of European recovery. Japanese economic prospects remain more tentative.

- Russian equity markets fell sharply this week, despite the IMF Board's approval of a $4.5 billion standby loan. Markets had already priced in approval of the IMF loan but were concerned by critical statements from IMF managment regarding Russia's past reserve management practices and by the fact that the Central Bank has recently been forced to intervene in the currency market to keep the ruble steady. Russian reserves fell $500M last week to $11B, their lowest level since March 1st.

Gold prices remained near recent lows despite fading prospects that Congress would approve the sale of IMF gold and despite rising U.S. inflation concerns and signs of stronger global growth that could increase demand for gold. We are currently exploring alternatives to IMF gold sales that would not negatively impact the gold market. We are close to a solution, which we plan to combine with a broader announcement, after the Congressional recess, of Administration support for an increased budgetary contribution for debt relief.

EXECUTIVE SECRETARIAT

Weekly Market Indicators for the Week Ending: *July 30, 1999*

11:04 AM

Major International Markets

Changes are Friday to Friday

	Exchange Rates Level	Exchange Rates % change	Equities Index	Equities Level	Equities % change	Ten-Year Government Bond Yields %	BP change
Japan	Y 114.75/$	-1.4%	*Nikkei*	17861.86	1.9%	1.79	9
Euro	$1.0706/EUR	-1.9%					
Euro-yen	$123.0400/EUR	0.5%					
Germany			*Xetra-Dax*	5101.87	-3.9%	4.81	14
U.K.			*FT-SE 100*	6196.5	-0.2%	5.35	12
France			*CAC-40*	4367.92	-1.6%	4.97	17
Italy			*MIB 30*	32523	-3.0%	5.09	17

^ U.S. dollar depreciation/appreciation

Emerging Markets

	Exchange Rates Level per USD	% change (local ccy)	Equities Index	Equities Level	Equities % change	Emerging Market Sov. Bond Spread* BP	BP change
Korea	1204	0.4%	*Kospi*	970	7.2%	221	-10
Indonesia	6830	1.6%	*JSE*	598	-4.5%	598	0
Thailand	37.175	0.6%	*SET*	457	-4.0%	214	10
Hong Kong	7.76125	0.0%	*Hang Seng*	13187	0.7%	170	-5
Brazil	1.7870	1.6%	*Bovespa*	10515	-4.6%	820	-32
Argentina	1.0000	0.0%	*Merval*	475	0.2%	704	29
Mexico	9.3935	-0.1%	*Bolsa*	5294	-7.1%	410	-1
Russia	24.215	0.2%	*RTS*	116	-8.5%	1903	-30
India	43.33	-0.1%	*Bombay SE*	4542	-2.8%	n/a	n/a
Turkey	429,465	0.0%	*ISE 100*	5805	0.4%	551	-9
South Africa	6.152	-0.7%	*JSE*	6391	0.1%	292	-20

Commodity Markets

	Level	% change
Gold	$256.05	0.49%
Oil	$19.96	3.47%

** spread on U.S. dollar-denominated sovereign debt to 10-year U.S. Treasuries*

Source: Bloomberg

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Lawrence H. Summers to POTUS re: Strategic Petroleum Reserve (2 pages)	09/13/00	P5

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jp34

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Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
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Prepared by David Wilcox
NCC faxed to LS 9/12PM
Economic Policy revised per
LS 9/13/00
NCC to LS (signature)
NCC cc to SS
TS
CK
LS signed (OK'ed M. Roney autopenning)
TR autopenned
TR original to WH
NCC cc to SE
Please Log IN and file
9/13/00

RUSSIA

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. memo	Lloyd Bentsen to POTUS re: Russian Economic Reform & the Washington Summit--Building Economic Partnership (5 pages)	09/26/94	P5

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
003. memo	Lawrence H. Summers to Secretary Bentsen re: Memorandum to the President on Russian Economic Reform & the Washington Summit (1 page)	09/23/94	P5

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MULTILATERAL SUPPORT FOR RUSSIAN ECONOMIC REFORM

At an April 1993 Tokyo conference, G-7 Foreign and Finance Ministers announced a support program for Russia to provide up to $43.4 billion. This extraordinary initiative reflected the critical importance to world peace of Russia's successful transition to a democratic market economy and Russia's special needs during this unique transition process.

The G-7 stands by its commitment to provide the full amount of support agreed upon at Tokyo. Of this total, about $29 billion has already been approved to support structural reform and initial efforts toward sound macroeconomic policies, and for debt rescheduling. The remainder of our support has not yet been activated because Russia has not yet made adequate progress in implementing a full stabilization program.

The report below provides an update on the status of the four parts of the Tokyo package (amounts are in billions of dollars) and on other G-7 support initiatives.

MULTILATERAL SUPPORT PROGRAM	AMOUNT	APPROVED
I. Support for Initial Stabilization	$4.1	$3.5

In 1993, the IMF created the Systemic Transformation Facility (STF) to support initial stabilization. Russia has drawn $3 billion under the STF in two equal tranches, in June 1993 and April 1994.

The World Bank also agreed to provide up to $1.1 billion in initial stabilization support through critical import loans. The Bank has disbursed almost all of the remaining $500 million under a $600 million critical import loan made in 1992 and a second loan of $600 million is expected to be approved this fall.

II. Support for Full Stabilization	$10.1	$0

The G-7 envisaged that Russia would move from initial stabilization supported by the STF toward full economic stabilization with the support of an IMF (standby) loan of up to $4.1 billion. Discussions between the IMF and Russia on a program that can be supported by an IMF standby loan are expected to begin in the second half of 1994.

The G-7 also agreed to create a $6 billion currency stabilization fund to support the ruble, once Russia has implemented a rigorous standby program for several months.

III. Support for Structural Reforms	$14.2	$10.6

Structural support for Russia is needed to help privatize industry, build market institutions and infrastructure, and develop sectors such as energy and agriculture. It can proceed apart from the pace of stabilization support.

The World Bank agreed to provide up to $3.4 billion in loans to support restructuring. Of this total $2.3 billion has now been approved, including loans to support oil sector restructuring, highway rehabilitation, financial institution development, and privatization. The EBRD also approved $250 million in co-financing for a World Bank oil sector loan.

Under the $300 million Small and Medium Enterprise Fund (SME) initiative, the G-7 and the EBRD will each provide $150 million to finance small emerging entrepreneurs. A pilot project is currently underway and will be reviewed as the basis for the entire project.

The G-7 agreed that their export credit agencies (ECAs) could provide $10 billion to finance needed capital imports. Over $5 billion in ECA assistance was granted in 1993 and the G-7 is prepared to offer a similar amount in 1994. The United States has approved close to $900 million in Eximbank guarantees and will provide up to $2 billion under our oil and gas framework agreement.

<u>IV. Official Debt Rescheduling</u> $15 $15

In April 1993, Paris Club countries rescheduled roughly $15 billion of official principal and interest payments due in 1993. The United States rescheduled $1.1 billion. (In June of this year the Paris Club countries concluded a new rescheduling agreement with Russia for debt due in 1994, which offers more favorable terms than last year's rescheduling.)

TOTAL MULTILATERAL SUPPORT $43.4 $29.1

<u>Special Privatization and Restructuring Program (SPRP)</u>

Responding to a U.S. proposal, G-7 Heads of State, the World Bank, IFC, and EBRD agreed in Tokyo to create the SPRP, to assist in restructuring large firms. The SPRP will provide up to $3 billion in equity, loans and ECA support for enterprise restructuring. A network of up to ten regional venture funds is being established to make investments in Russian firms.

The United States contributed $100 million in grant support under the SPRP to create the Fund for Large Enterprise Restructuring (FLER). The FLER is now up and running under former Treasury Secretary Michael Blumenthal, and will provide equity and loans to newly privatized Russian firms. The United States also pledged $250 million in ECA support under the SPRP.

<u>Support Implementation Group (SIG)</u>

At the Vancouver Summit, Presidents Clinton and Yeltsin agreed to explore creation of a body to coordinate external assistance for Russian reform. The United States took the lead in creating the SIG, which was endorsed by the G-7 in Tokyo and initiated its activities on September 1 of last year in Moscow.

STATUS REPORT ON THE FIVE INITIATIVES PRESIDENT PROPOSED TO PRESIDENT YELTSIN IN JANUARY

In January, President Clinton proposed five initiatives to President Yeltsin to accelerate the pace of Russian reform and Western support. Below is a status report on these initiatives.

1. **Intensified engagement by G-7 Finance Ministries has moved the IMF and World Bank to deepen their support for Russian reform.** Efforts by the IMF and World Bank to support Russian reform were flagging last year. Responding to direction from the G-7, both institutions have revitalized their programs this year. IMF Managing Director Camdessus traveled to Russia in March and worked personally with Prime Minister Chernomyrdin to get agreement on a new $1.5 billion IMF loan. The World Bank completed a $1.5 billion pipeline of projects by July and plans a substantial increase in its fiscal year 1995 lending.

2. **Efforts are underway to mobilize further multilateral financing.** We are urging the IMF and Russia to work together on a 1995 economic program that can be supported by a new $4 billion IMF loan this autumn. The G-7 is prepared to finance a $6 billion fund to stabilize the ruble as part of an overall economic stabilization effort. We have also secured agreement of other Paris Club creditors to consider a comprehensive multi-year rescheduling of official debt when Russia and the IMF agree on a 1995 program.

3. **IMF resources available for Russia and other ex-Soviet states will soon be expanded.** Former Soviet countries face unprecedented challenges as they strive to build democratic market economies while reknitting their social safety nets and maintaining public support for reform. At our urging, the G-7 countries have agreed that the IMF should raise the amount of support available to these countries. Work on this initiative is well-advanced and we expect the results to be announced in early October at the Annual Meetings of the IMF and World Bank.

- By increasing the amounts the IMF can lend under traditional programs, Russia could draw $1.4 billion more annually.

- Russia has drawn $3.0 billion from the IMF's special systemic facility. By extending this facility, Russia will be eligible for further borrowing of more than $2 billion.

- The IMF could distribute a special reserve asset to former Soviet countries, which could provide Russia with close to $1.5 billion.

4. **Support for Russia's social infrastructure is being expanded under a number of initiatives.** The World Bank recently approved a $1.5 billion pipeline of projects, including loans to maintain highways ($300 million), rehabilitate the oil sector ($500 million), develop financial sector infrastructure ($200 million), and advance agricultural reform ($240 million).

The $3 billion Special Privatization and Restructuring Program is building a network of equity funds to help restructure large privatized firms. This may include a $500 million World Bank loan to help transfer social services from firms to the public sector.

The Bank is considering other social loans, including $400 million for housing and $150 million to support renovation of clinics, schools, and day care centers at the local level. It is also planning a program to transfer operation of kindergartens from enterprises to local governments.

5. **The G-7 rescheduled Russia's official debt due in 1994 on very favorable terms.** In June the G-7 concluded a rescheduling that gives Russia more favorable terms than last year, requiring only $3 billion in payments to official creditors this year. Unlike last year, the agreement was reached quickly, to the satisfaction of all parties.

TREASURY CLEARANCE SHEET

NO. 94-138098
Date ______

MEMORANDUM FOR: x SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
x ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: UNDER SECRETARY SUMMERS
SUBJECT: MEMO TO THE PRESIDENT ON RUSSIAN ECONOMIC REFORM AND THE WASHINGTON SUMMIT

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt
x Under Secretary (International) ☐ IRS
x International Affairs
☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
x General Counsel
☐ Inspector General
☐ Legislative Affairs
☐ Management
☐ OCC
☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
MSobel	MS	9/22/94	IEF	622-0121
REVIEWERS				
JShafer	—		I	622-0060
GC Office			GC	622-0287

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

Draft: Mark Sobel

Review: David Lipton

MS 9/22

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NO. 44-138098
Date______

MEMORANDUM FOR: x SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
x ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

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SUBJECT: MEMO TO THE PRESIDENT ON RUSSIAN ECONOMIC REFORM AND THE WASHINGTON SUMMIT

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☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt
x Under Secretary (International) ☐ IRS
x International Affairs
☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
x General Counsel
☐ Inspector General
☐ Legislative Affairs
☐ Management
☐ OCC
☐ Policy Management
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JShafer	—		I	622-0060
GC Office	DJ	9/23	GC	622-0287

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

DO F 80-02.1 (04/89)

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
004. memo	Lloyd Bentsen to POTUS re: Ukraine: Economic Reform & the Kuchma State Visit (3 pages)	11/18/94	P5

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RESTRICTION CODES

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94-139813

DEPARTMENT OF THE TREASURY
WASHINGTON

UNDER SECRETARY

November 17, 1994

MEMORANDUM FOR SECRETARY BENTSEN

FROM: LAWRENCE H. SUMMERS

SUBJECT: MEMO TO THE PRESIDENT ON UKRAINIAN ECONOMIC REFORM AND PRESIDENT KUCHMA'S STATE VISIT

ACTION FORCING EVENT

Ukraine's President, Leonid Kuchma, will visit Washington on November 22-23 for a state visit. President Clinton's discussions with him will focus importantly on Ukraine's economic reform program and Western financial support for it. Treasury has worked closely with Ukraine's leadership in urging that Ukraine proceed down the path of reform and in mobilizing G-7 financial support. For these reasons, I believe it would be extremely useful for the President to receive your views on these issues.

RECOMMENDATION

That you send the attached memo to the President

Agreee ______ Disagree ______ Let's Discuss ______

EXECUTIVE SECRETARIAT

TREASURY CLEARANCE SHEET

NO.______

Date: 11/16/94

MEMORANDUM FOR: X SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
X ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER

FROM: Under Secretary Summers

SUBJECT: Memo to the President On Ukrainian Economic Reform

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt
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- ☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds
- ☐ Other______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Jim Carlen Mark Sobel David Lipton	MS [illegible]	11/16	IEF	622-0108
REVIEWERS				
Jeff Shafer			I	622-0060
Ed Knight	[illegible]	11/17	G	622-0287

SPECIAL INSTRUCTIONS

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☐ Executive Secretary ______ Date

DO F 80-02.1 (04/89)

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
005. memo	Robert E. Rubin to Vice President Gore re: Economic Themes for Upcoming Visit of Ukrainian Prime Minister (1 page)	09/21/95	P5

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95-150238

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

ACTION MEMO

ACTION

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Lawrence Summers
Deputy Secretary

FROM: Jeffrey Shafer
Assistant Secretary (International Affairs)

SUBJECT: Memo to Vice President Gore on Economic Themes for Visit of Ukrainian Prime Minister

ACTION FORCING EVENT:

Yevhen Marchuk, Prime Minister of Ukraine will be in Washington September 27-28. He will be meeting with Vice President Gore and other cabinet members. This memo outlines the key economic themes which should be highlighted during those meetings. A background paper is provided also which provides additional information on the status of reform.

RECOMMENDATION:

That you sign the attached memorandum to Vice President Gore.

Agree ___√___ Disagree ________ Let's Discuss _______

BACKGROUND ANALYSIS:

Prime Minister Marchuk's visit comes at an important time in Ukraine's economic transformation effort. While progress has been made toward stabilizing the economy, reform momentum has slowed and Ukraine still has not completed its second IMF standby review. Recently, the Government again has suggested weakening stabilization to help boost output.

This memo lays out the key economic messages which should be delivered to the Prime Minister during his meetings with Vice President Gore and other cabinet officials. Marchuk needs to become actively involved in pushing forward Ukraine's economic reforms.

In response to your inquiry about what the United States can do to support Ukraine's reforms: Marchuk's visit is a key opportunity to send the messages outlined in this memo. The Administration is working also to adjust its financial support program to better meet Ukraine's immediate needs. To improve the quality of Ukraine's economic policies, the USG is preparing to send out a group of resident advisors to work in Kiev. This project will concentrate on all major areas of macroeconomic policy.

ATTACHMENT:

Tab 1: Memorandum to Vice President Gore
Tab 2: Background on Economic Reform in Ukraine

EXECUTIVE SECRETARIAT

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
006. briefing paper	re: Current Economic Situation in Ukraine (2 pages)	circa Sept. 1995	P5

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TREASURY CLEARANCE SHEET

NO. 95-150238
Date 9/21/95

MEMORANDUM FOR: X SECRETARY ☐DEPUTY SECRETARY ☐UNDER SECRETARY

X ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ________

FROM: Jeffrey Shafer, Assistant Secretary (International Affairs)
SUBJECT: Memo to Vice President Gore

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
ATF
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt
☐ Under Secretary for International Affairs
☐ International Affairs
☐ Enforcement
☐
☐ Scheduling
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC
☐ Policy Management
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other ________

NAME (Please Type)	INIT.	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
JCarlen	jc	9-15-95	IEF	622-2130
REVIEWERS				
				622-0287
JShafer				
EKnight				

SPECIAL INSTRUCTIONS

☐ Review Officer ________ Date ________ ☐ Executive Secretary Date

DO F 80-02.1 (04/89)

Clearance Sheet for Memo from Assistant Secretary Shafer to Secretary Rubin:

Drafted By: JCarlen, IEE (x20122) JC 9/15/95

Reviewed By: MSobel, IEE

DLipton, IE DL 9/15/95

Withdrawal/Redaction Marker
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
007. memo	Robert E. Rubin to Vice President Gore re: Gore-Chernomyrdin Commission Meeting (1 page)	01/11/96	P5

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COLLECTION:

Clinton Administration History Project

OA/Box Number: 24124

FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [5]

jp34

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

TREASURY CLEARANCE SHEET

NO.__________
Date__________

MEMORANDUM FOR: X SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY

X ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER __________

FROM: Jeffrey R. Shafer, Under Secretary, International Affairs
THROUGH: Lawrence Summers, Deputy Secretary
SUBJECT: Proposed Meeting with Russian Prime Minister Viktor Chernomyrdin

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
- ☐ Enforcement
  - ☐ ATF
  - ☐ Customs
  - ☐ FLETC
  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
  - ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
- ☐ Savings Bonds
  - ☐ Other

NAME (Please Type)	INIT.	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Wes McGrew	wm	12/27/95	IEE	622-2876
REVIEWERS				
David Lipton	DL	12/29/95	I	622-1270
Ed Knight			G	622-0027

SPECIAL INSTRUCTIONS

☐ **Review Officer** **Date** ☐ **Executive Secretary** **Date**

DO F 80-02.1 (04/89)

Subject: Proposed Meeting with Russian Prime Minister Viktor Chernomyrdin

Initiator: Wes McGrew/IEE WM 12/27/95

Reviewers: Mark Sobel/IEE

Russ Munk/GI

Withdrawal/Redaction Marker
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
008. memo	Under Secretary Shafer to Secretary Rubin re: Proposed Meeting with Russian Prime Minister Viktor Chernomyrdin (1 page)	circa Jan. 1996	P5

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COLLECTION:

Clinton Administration History Project

OA/Box Number: 24124

FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [5]

jp34

RESTRICTION CODES

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