International financial developments

The main points in the latest period are:

- *The combined current account deficit of the major seven OECD countries contracted in the fourth quarter but, for the year as a whole, was four times greater than in 1983. A further substantial increase in the US deficit was primarily responsible.*

- *During 1984 the current account position of developing countries continued the improvement which started in 1983, though experience varied.*

- *Announced syndicated credits continued to decline in the fourth quarter. December saw the lowest level of announcements for a decade and activity remained depressed in January and February. By contrast, note issuance facilities have increased markedly.*

- *Issues of fixed-rate bonds and floating-rate notes remained buoyant. In the fixed-rate sector borrowers from the United States and Japan were particularly active during January and February. Liberalisation measures by the Japanese authorities led to a surge of euroyen issues in December which has continued into 1985.*

- *UK banks' external lending grew modestly in the fourth quarter. Foreign currency deposits also increased although deposits of oil exporting countries fell sharply. In December the policy of restricting official sterling holdings to working levels was discontinued.*

- *In the foreign exchange market the dollar climbed to new highs against all major currencies, including sterling. In the context of the dollar's strength the finance ministers and central bank governors of five major countries[1] met on 17 January and expressed their commitment to work towards greater exchange market stability and to undertake co-ordinated intervention in the markets as necessary.*

Balance of payments positions

The combined current account deficit of the *major seven economies* improved markedly in the fourth quarter of 1984 as imports declined in the United States and Japan. Despite this fourth quarter improvement the deficit for the year as a whole was four times greater than in 1983. The deterioration was more than accounted for by the United States where the strength of economic recovery and reduced competitiveness associated with the rise of the dollar combined to produce a deficit of over $100 billion.

The US deficit first emerged in the second half of 1982 and has widened dramatically since then. Although a portion of the capital inflow has not been identified, the deficit has largely been financed by private short-term dollar inflows, predominantly through the banking system. Since the second quarter of 1983, banks in the United States have cut back their external lending and have been net borrowers from non-residents. This is a

World current accounts[(a)]
$ billions; *seasonally adjusted*

	1983	1984				
	Year	Year	Q1	Q2	Q3(b)	Q4(b)
OECD economies:						
Canada	1	2	—	1	1	1
France	- 5	—	- 1	- 1	1	1
Germany	4	6	1	—	2	4
Italy	1	- 3	—	- 1	—	- 1
Japan	21	35	7	9	7	11
United Kingdom	3	—	1	—	- 1	1
United States	-42	-105	-20	-24	-34	-27
Major economies	-16	- 65	-11	-17	-24	-11
Other OECD	- 8	..	- 1	—	—	..
Total OECD	-24	..	-12	-17	-24	..
Oil exporting economies	-15	..	1	2	2	..
Other developing economies	-41	..	- 7	- 8	- 6	..
Other economies(c)	3	..	1	1	1	..
World discrepancy(d)	-77	..	-17	-22	-27	..

.. not available.

(a) Components may not sum to totals because of rounding.
(b) Includes Bank estimates/forecasts.
(c) South Africa and the centrally planned economies.
(d) Reflecting errors and omissions arising from incomplete coverage, timing differences and other statistical deficiencies.

(1) France, Germany, Japan, United Kingdom and United States.

US net capital flows

$ billions; capital outflow –, inflow +

	1982	1983	1984(a)
Current account	**– 9.2**	**–41.6**	**–104.6**
Capital account	**14.1**	**42.7**	**107.3**
Direct investment	19.6	6.4	18.4
Portfolio investment	5.4	9.7	20.6
Banking flows	– 45.2	23.7	33.8
of which:			
Assets	*–111.1*	*–25.4*	*– 0.4*
Liabilities	*65.9*	*49.1*	*34.2*
Other private sector flows	4.2	– 6.7	16.3
Government flows(b)	– 2.8	0.3	–12.0
Balancing item	32.9	9.3	30.2
Official financing	**– 5.0**	**– 1.2**	**– 2.7**

(a) First three quarters (not seasonally adjusted) at annual rate.

(b) Comprises US government assets other than reserves, plus foreign official assets in the United States.

reversal of their accustomed role in international markets over the past decade. Net inflows associated with portfolio investment and also foreign lending to US non-banks have become progressively larger. By contrast net direct investment has not increased much since 1982.

Strong growth in the US economy during 1984 contributed to improved current account positions in most other major OECD economies. In Japan the surplus continued to increase reaching $35 billion, while in Germany and Canada surpluses also rose, albeit not so rapidly. In France the deficit that obtained in 1983 was virtually eliminated. In Italy, however, buoyant domestic activity and the strong position of the lira within the European Monetary System combined to move the current account into deficit, and in the United Kingdom the small surplus recorded in 1983 was eroded to near balance mainly through the impact of the coal strike.

The combined current account of the *smaller OECD countries* continued the improvement begun in the first half of last year. A notable recovery has occurred in Spain while the Netherlands, Norway and Switzerland continued to run sizable surpluses.

The improvement during the first half of 1984 in the combined current account of the *oil exporting countries* was not maintained in the third quarter. A weak oil market depressed energy export earnings, outweighing the gains from a further cut-back in imports.

The current account deficit of the *non-oil developing countries* declined slightly in the third quarter of 1984 as import volumes grew less quickly than in the second quarter, export volume growth was sustained and the deficit on invisibles, estimated at $5 billion, remained roughly unchanged. During the first nine months of 1984 the non-oil developing countries have continued to improve their aggregate current account position though individual experience has varied. A $21 billion deficit in the first three quarters of 1984 compared favourably with $32 billion for the same period of 1983. A major factor underlying this improvement continues to be good export performance. Export volumes, particularly to the United States, grew strongly throughout the first three quarters of the year, with south east Asian and some Latin American countries benefiting most and African countries doing less well.

Capital inflows have continued to be sufficient to cover the non-oil developing countries' deficit and to allow reserves to be built up in all three quarters, particularly the second. Use of IMF credit declined, as did borrowing from banks. There were signs of a slight recovery of both direct investment and concessionary and other official flows during 1984. Borrowing via bond issues picked up in the third quarter and this recovery continued into the last quarter of the year, with much of the money raised by Far Eastern countries.

Developing countries' balance of payments

$ billions; *not seasonally adjusted*

	1982	1983		1984(a)		
	Year	Year	Q4	Q1	Q2	Q3
Current account	**–67**	**–41**	**–10**	**–7**	**– 8**	**–6**
Capital account	**54**	**35**	**6**	**7**	**11**	**7**
of which:						
Concessionary and other official flows	23	22	6	6	6	7
Direct investment	10	8	2	2	3	3
Borrowing from banks(b)	20	12	4	1	3	1
Borrowing via bond issues	3	2	1	1	—	1
Other capital flows(c)	– 2	– 9	– 7	–3	– 1	–5
Official financing balance	**13**	**6**	**4**	**—**	**– 3**	**–1**
of which:						
Use of IMF credit	5	10	2	1	2	1
Liabilities to other CMIs	2	1	2	1	—	1
Reserves(b) etc (increase–)	6	– 4	—	–2	– 5	–2

(a) Includes Bank estimates/forecasts.

(b) Adjusted to exclude valuation effects.

(c) Including net errors and omissions.

International capital markets

The article on page 57 examines developments in international capital markets in 1984. This section concentrates on the latest developments.

Medium-term syndicated bank credits[1]

The level of announcements in the syndicated credits market, which had been running at $7–8 billion per quarter for the previous five quarters, fell to less than $6 billion in the final quarter of 1984. December's total of only $0.5 billion was the lowest monthly figure for a decade, and there was little pickup in activity in the first two months of 1985. Borrowing by OECD countries was particularly depressed, with only Portugal and Spain raising sizable amounts in January and February.

There was continued borrowing by oil exporting countries, with announcements of $1.6 billion in the fourth quarter of 1984, and also by Eastern bloc countries—deals announced early in 1985 for both the Soviet Union and East Germany were well received.

Announcements of spontaneous syndicated credits for developing countries totalled $1.4 billion in the fourth

(1) Figures and comments relate to announcements not to drawings on credits.

'Spontaneous' medium-term credits

$ billions

	Total	Major OECD	Minor OECD	Non-OECD	*of which:* Oil exporting countries	Developing countries	Eastern bloc
1982 (a)	**22.31**	5.92	4.60	11.79	*3.45*	*7.85*	*0.13*
1983 (a)	**9.53**	2.04	3.39	4.10	*1.38*	*2.17*	*0.14*
1984 Q1	**7.30**	1.97	1.53	3.80	*0.94*	*1.93*	*0.51*
Q2	**7.67**	3.27	1.07	3.33	*0.39*	*2.11*	*0.50*
Q3	**8.58**	3.57	1.85	3.16	*0.78*	*1.62*	*0.58*
Q4	**5.93**	1.12	1.21	3.60	*1.60*	*1.43*	*0.54*
1985 Jan.	**1.12**	0.15	0.46	0.51	*0.34*	*0.13*	—
Feb.	**1.71**	0.07	0.38	1.26	*0.03*	*0.65*	*0.57*

(a) Quarterly average.

quarter of 1984, a little less than in the previous quarter. South Korean borrowers were particularly active. The largest deal for any borrower in the first two months of 1985 was a $600 million syndication for the Korea Exchange Bank.

Note issuance facilities

The popularity of note issuance and similar facilities, particularly among borrowers from OECD countries, increased markedly in the fourth quarter of 1984 when $5.6 billion of facilities were completed—compared with $2.4 billion in the previous quarter. In January and February 1985 a further $3.5 billion were completed while another $1.7 billion were being arranged. Facilities were also arranged for many non-OECD borrowers, including oil exporting countries—Oman and Saudi Arabia—and developing countries—Singapore, South Korea and India—as well as for the European Investment Bank and the African Development Bank.

Completed note issuance facilities:[(a)] analysis of borrowers

	Major OECD	Minor OECD	Other	**Total**	*of which:* Industrial	Financial	Government
1981(b)	—	0.12	0.11	**0.23**	*0.08*	*0.03*	*0.12*
1982(b)	0.13	0.29	0.19	**0.61**	*0.29*	*0.17*	*0.15*
1983(b)	0.43	0.31	0.06	**0.80**	*0.36*	*0.44*	—
1984 Q1	0.10	0.10	0.12	**0.32**	*0.12*	*0.20*	—
Q2	0.47	0.68	0.10	**1.25**	*0.38*	*0.37*	*0.50*
Q3	0.55	1.68	0.21	**2.44**	*0.60*	*0.84*	*1.00*
Q4	2.84	2.05	0.70	**5.59**	*3.74*	*0.85*	*1.00*(c)
1985 Jan.	0.11	0.85	0.10	**1.06**	*0.89*	*0.07*	*0.10*
Feb.	1.09	1.20	0.18	**2.47**	*2.07*	*0.40*	—

(a) Generic term encompassing revolving underwriting facilities, note purchase facilities, and euronote facilities. Data exclude multiple component facilities.
(b) Quarterly average.
(c) Includes $500 million for international institutions.

Fixed-rate bonds

Issues of fixed-rate bonds completed in the fourth quarter of 1984 rose to $24 billion, an increase of 42% from the third quarter rate. Borrowers from the United States—including for the first time the US Treasury—accounted for more than half the increase. Activity continued to be high in the first two months of 1985 with total issues of $18 billion. Japanese and US borrowers increased their share of fixed-rate issues to nearly 60% in January and February from an average of 44% during 1984. Borrowings by Japanese entities during this period included nearly $2 billion in straight fixed-rate dollar issues, a large proportion of which were bought by Japanese institutions.

A surge in euroyen issues by US borrowers followed the move by the Japanese authorities to open the euroyen market to certain non-Japanese corporations from the beginning of December. This, combined with the largest ever Samurai bond—a ¥100 billion issue for New Zealand—resulted in the yen's share of total fixed-rate issues rising from 7% in the first eleven months of 1984 to 14% in the period December–January. A ¥25 billion euroyen issue for the Student Loan Marketing Association, a US federal agency, was the first foreign-targeted issue to be denominated in a currency other than the US dollar.

Floating-rate notes

Issues of floating-rate notes (FRNs) in the fourth quarter of 1984 rose by $3 billion from the third quarter rate to reach $11 billion. Banks from the major OECD countries accounted for half the total amount raised. Activity slackened in the first two months of 1985 with new issues totalling only $5 billion, 35% of which were for US banks.

Refinancing of outstanding FRNs and syndicated loans was an important motive for new FRN issues, which continued to be tightly priced. Innovations in the period included the use of FRNs to refinance ECGD guaranteed debt and a package of UK mortgages.

International banking developments[(1)]

Activities of banks in the BIS reporting area in the year to end-September 1984 and of banks in London in calendar 1984 are described in the article on page 57. This section focuses on the latest developments. There have been a number of changes in the statistical series used to compile this part of the review.

Banks in the BIS reporting area[(2)] *(third quarter of 1984)*

Identified external lending of banks in the BIS area fell in the third quarter of 1984. This was the first third-quarter fall since 1974 following the Herstatt bank collapse, and occurred despite the seasonal increase in the operations of Japanese banks. The contraction may be overstated because the BIS statistics do not allow fully for the increasing use by borrowers of floating-rate notes and bonds. It was due mainly to a sizable reduction in the interbank claims of banks in the United States as they reversed their second quarter funding of their affiliates abroad. As a result, banks in the United States re-emerged in the third quarter as substantial net takers of funds from the international banking markets.

(1) All flows exclude the estimated effects of movements in exchange rates between the US dollar and other currencies, unless otherwise stated.
(2) As from end-1983, the BIS reporting area was expanded to include Finland, Norway and Spain, and offshore banking operations in Bahrain and the Netherlands Antilles. In addition, the business of non-US banks in the Bahamas, Cayman Islands, Hong Kong and Singapore is now covered to complement data previously available from the offshore branches of US banks operating in these countries.

Completed international bond issues[a]

	1984 Q1	Q2	Q3	Q4	1985 Jan.	Feb.
Fixed-coupon bonds					*$ billions*	
Borrower						
Major OECD countries	11.3	7.9	10.1	14.6	5.2	7.5
of which:						
United States	*4.0*	*1.9*	*3.8*	*8.0*	*2.6*	*3.6*
Japan	*4.1*	*3.3*	*3.5*	*2.9*	*1.5*	*2.6*
Minor OECD countries	2.4	3.0	2.9	4.1	1.4	1.0
International institutions	2.9	2.2	3.0	4.2	1.3	0.8
Other	0.2	0.5	0.5	0.6	0.3	0.1
Total	**16.8**	**13.6**	**16.5**	**23.5**	**8.2**	**9.4**
Currency					*Percentages*	
US dollars	42.5	36.2	52.6	56.3	49.2	58.5
Swiss francs	24.5	27.2	17.0	9.8	13.2	10.3
Yen	4.5	11.2	7.6	10.0	10.3	10.9
Other	28.5	25.4	22.8	23.9	27.3	20.3
Floating-rate notes						
Borrower					*$ billions*	
Major OECD	5.3	3.1	5.7	7.2	0.8	3.2
Minor OECD	2.4	2.6	2.0	2.7	0.1	0.6
Other	0.9	0.2	0.4	1.4	0.3	0.3
Total	**8.6**	**6.0**	**8.1**	**11.4**	**1.3**	**4.1**

(a) Maturities of one year and over. The table includes euro and foreign issues and publicised private placements. It excludes Canadian borrowing in New York.

The growth in lending to countries outside the reporting area slowed considerably in the third quarter. Most of the slowdown resulted from a fall in the level of outstanding claims on oil exporting countries. In addition, lending to non-oil developing countries grew less rapidly than in the second quarter. Outside-area countries were again modest net suppliers of funds to BIS-area banks.

The latest half-yearly maturity analysis of consolidated lending[1] to countries outside the reporting area at end-June 1984 shows a further marked lengthening in the maturity structure of BIS-area banks' claims on non-oil developing countries. In particular, this reflects a lengthening of Mexico's repayments profile following recent debt reschedulings.

Eurosterling liabilities of banks in the BIS area (excluding the United Kingdom) continued to rise in the third quarter. Deposits by UK non-banks rose marginally, the first increase for a year. Growth on both sides of the balance sheet was dominated by increased business with banks in the United Kingdom.

Eurosterling market

£ billions

	1983 30 Sept.	31 Dec.(a)	1984 31 Mar.	30 June	30 Sept.
Deposits by:					
UK banks	3.1	3.3	3.9	4.5	5.2
UK non-banks	1.2	1.2	1.2	1.2	1.3
Other banks in BIS area	4.4	4.6	5.2	5.6	5.7
Other non-banks in BIS area	0.7	0.9	1.0	1.0	1.0
Oil exporting countries	0.5	0.4	0.4	0.5	0.5
Other	1.8	1.6	1.6	1.6	1.6
Total	**11.7**	**12.0**	**13.3**	**14.4**	**15.3**
of which, CMIs	*0.3*	*0.3*	*0.5*	*0.5*	*0.4*
Lending to:					
UK banks	4.6	4.8	5.4	6.1	6.9
UK non-banks	0.8	0.7	0.7	0.9	0.9
Other banks in BIS area	3.0	3.3	3.5	3.9	3.8
Other non-banks in BIS area	1.5	1.8	2.1	2.1	2.2
Other	0.7	0.7	0.8	0.6	0.7
Total	**10.6**	**11.3**	**12.5**	**13.6**	**14.5**

Source: Bank for International Settlements.

(a) Finland, Norway, Spain, Bahamas, Bahrain, Cayman Islands, Hong Kong, the Netherland Antilles and Singapore became part of the BIS reporting area at end-December 1983.

External sterling liabilities and assets of banks in the United Kingdom by customer[a]

£ billions

	1983 30 Sept.	31 Dec.	1984 31 Mar.	30 June	30 Sept.	31 Dec.
Liabilities						
Overseas central monetary institutions(b)	2.1	2.3	2.6	2.7	2.9	3.4
Own offices overseas	2.9	3.0	2.9	3.2	3.6	3.7
Other banks overseas	6.7	7.2	8.1	9.5	10.1	10.2
Other non-residents	10.4	11.1	11.5	11.8	12.3	13.1
Total liabilities	**22.1**	**23.6**	**25.1**	**27.2**	**28.9**	**30.4**
Assets						
Loans and advances to:						
Own offices overseas	1.5	1.6	1.7	2.1	2.2	2.2
Other banks overseas	2.8	3.0	3.6	4.2	4.5	5.0
Other non-residents	4.3	4.6	4.9	5.2	5.6	6.3
Bills	5.8	6.0	6.1	6.1	6.2	6.2
Acceptances	2.9	3.0	3.6	3.4	3.7	3.6
Total assets	**17.3**	**18.2**	**19.9**	**21.0**	**22.2**	**23.3**

(a) The reporting population is broader than the UK monetary sector (see notes and definitions to Table 16 in the statistical annex).
(b) Includes international organisations.

External sterling business of banks in the United Kingdom again grew strongly in the fourth quarter. The increase in deposits came mainly from non-banks overseas, who were also the principal borrowers. Towards the end of the period, on 18 December, the policy of restricting official sterling holdings to working levels was discontinued.

External lending in sterling and foreign currencies of UK banks in total grew modestly in the fourth quarter after falling in the previous quarter. Lending went mainly to banks in other BIS-area countries. Deposits, which rose more than twice as much as lending, came mainly from non-banks in other BIS-area countries.

External business of banks in the United Kingdom by area

$ billions; changes adjusted to exclude exchange rate effects

	1983 Q4	1984 Q1	Q2	Q3	Q4
Deposits from:					
BIS reporting area(a)	+ 8.3	+ 9.2	+11.4	−2.8	+7.7
Offshore banking centres	− 3.3	+ 4.6	− 0.9	+0.7	+0.7
Other Western Europe(a)	+ 1.0	− 0.1	− 2.2	+0.6	+0.3
Australia, New Zealand and South Africa	+ 0.1	+ 0.1	—	—	+0.1
Eastern Europe	+ 0.8	+ 0.4	− 0.1	−0.6	+1.2
Oil exporting countries	− 2.3	+ 1.5	+ 1.6	+0.4	−2.4
Non-oil developing countries	+ 1.6	+ 2.5	+ 2.7	−1.9	+1.4
Others(b)	—	+ 0.7	+ 2.5	−0.7	+0.3
Total	**+ 6.2**	**+18.9**	**+15.0**	**−4.3**	**+9.3**
Lending to:					
BIS reporting area(a)	+ 3.5	+14.3	+ 0.1	−3.2	+5.4
Offshore banking centres(b)	+ 1.5	− 0.7	+ 8.7	+1.4	−1.0
Other Western Europe(a)	− 0.1	—	− 0.1	+0.3	+0.2
Australia, New Zealand and South Africa	+ 1.5	+ 0.2	+ 0.5	−0.1	+0.2
Eastern Europe	+ 0.3	− 0.1	− 0.2	—	−0.1
Oil exporting countries	+ 2.6	+ 0.7	+ 0.9	−0.9	−0.7
Non-oil developing countries	+ 0.8	+ 0.7	+ 1.0	−0.4	−0.2
Others(b)	+ 0.1	+ 0.1	+ 1.0	−0.7	+0.1
Total	**+10.2**	**+15.2**	**+11.9**	**−3.6**	**+3.9**

(a) Excluding offshore reporters.
(b) Including BIS reporters and other offshore centres.

(1) With effect from end-December 1983, the BIS maturity analysis moved onto an almost fully consolidated basis and statistics for that date and for end-June 1984 are not directly comparable with those for earlier periods. A description of the new series and the effects of the change is given in the notes and definitions to Table 13.2 in the statistical annex.

Foreign currency liabilities and assets of banks in the United Kingdom by customer[(a)]
$ billions: adjusted to exclude estimated exchange rate effects

	1984 Q1	Q2	Q3	Q4	Outstanding at end-Dec. 1984
Liabilities					
Deposit liabilities to:					
Other UK banks	+ 9.1	− 4.5	+ 1.6	− 6.5	138.2
Other UK residents	+ 1.6	− 2.3	+ 0.4	+ 2.4	27.6
Overseas central monetary institutions	− 1.5	+ 1.5	+ 4.4	+ 2.8	50.7
Own offices overseas	+ 7.7	+ 4.9	− 4.1	− 1.2	94.5
Other banks overseas	+ 4.5	+ 6.1	+ 1.5	+ 0.8	220.4
Other non-residents	+ 2.9	+ 2.2	− 5.7	+ 1.9	129.9
Other liabilities(b)	+ 0.6	+ 2.0	+ 0.3	+ 0.7	10.4
Total liabilities	**+24.9**	**+ 9.9**	**− 1.6**	**+ 1.0**	**671.7**
Assets					
Loans and advances to:					
Other UK banks	+ 9.4	− 4.0	+ 2.0	− 5.0	137.8
Other UK residents	+ 1.2	+ 0.7	+ 0.3	+ 0.4	33.9
Own offices overseas	+ 7.0	+ 2.0	− 5.2	− 1.0	151.8
Other banks overseas	+ 2.1	+ 8.8	− 0.4	+ 3.4	184.0
Other non-residents	+ 1.7	+ 0.2	− 0.7	− 1.3	126.0
Other assets(b)	+ 2.8	+ 1.0	+ 2.7	+ 2.7	34.9
Total assets	**+24.2**	**+ 8.7**	**− 1.3**	**− 0.7**	**668.4**

(a) The reporting population is broader than the UK monetary sector (see notes and definitions to Table 14 in the statistical annex).

(b) Mainly capital and other internal funds on the liabilities side and investments on the assets side.

Foreign currency lending at home and abroad by banks in the United Kingdom decreased for the second consecutive quarter mainly as a result of a large fall in claims on UK banks, only partly offset by a rise in lending to banks overseas. Liabilities to UK banks also fell but there were further sizable increases in the deposits of overseas central monetary institutions.

Deployment of oil exporters' funds

The article on page 69 reviews the way oil exporters' funds were deployed between 1974 and 1983. This section focuses on more recent developments using statistics collected on a new basis. The table differs from those previously published in this series since it includes *for the first time data from six additional financial centres which have recently begun reporting to the BIS but* excludes *figures on assets deployed by Bahrain which is no longer treated in the BIS statistics as an oil exporting country. The net effect of these changes is to add some $12 billion to the oil exporting countries' identified stock of assets.*

In the first quarter of 1984, the oil exporters ran down their assets by a further $3.1 billion, continuing the trend of 1983. This trend was reversed in the two succeeding quarters reflecting the improved combined current account position in 1984. Much of the increase has been channelled into bank deposits in the main industrial countries. By contrast, deposits in offshore centres have decreased. Holdings of less liquid assets in industrial countries also increased, except in the United Kingdom and the United States where government paper and other investments were run down. Provisional figures for the fourth quarter indicate a sharp reduction in eurocurrency deposits in the United Kingdom, but a rise in bank deposits in the United States and Japan.

Foreign exchange and gold markets

This section reviews developments in the three months to end-February

The dominating feature of the foreign exchange markets continued to be the US dollar, which progressively reached new highs against all major currencies. Sentiment in favour of the dollar remained strong with inflows attracted by vigorous economic growth, low inflation and high real interest rates. At times, this demand for dollars seemed to feed on itself. The market did, however, exhibit some nervousness about central bank intervention against the dollar, particularly after 17 January, when the Group of Five finance ministers and central bank governors discussed the extraordinary rise of the dollar at a meeting in Washington and reaffirmed their collective commitment to undertake co-ordinated intervention as necessary. Nevertheless, despite some co-ordinated intervention shortly afterwards, expectations emerged that US monetary policy would tighten, and underlying sentiment in favour of the dollar enabled it to breach the DM 3.18 level—below which it had remained for virtually the whole of January—and the dollar resumed its upward advance to reach new highs against all major currencies. Bullishness towards the dollar was reinforced by President Reagan apparently ruling out more forceful intervention to push the dollar down. In the last week of February, however, following comments by Federal Reserve

Identified deployment of oil exporters' funds[(a)]
$ billions

	Dec. 1983 levels	1984 Q1	Q2	Q3	Q4(b)	Sept. 1984 levels
United Kingdom:						
Sterling bank deposits	4.9	0.1	0.5	0.2	0.1	4.9
Eurocurrency bank deposits	43.9	− 0.2	0.4	0.8	−2.9	44.4
British government stocks	3.4	− 0.1	−0.3	0.1	—	2.6
Other investments(c)	4.0	− 0.1	−0.2	−0.1	—	3.6
	56.2	− 0.3	0.4	1.0	−2.8	55.5
United States:(d)						
Bank deposits	17.7	−1.1	2.5	0.5	1.5	19.6
Treasury bonds, notes and bills	34.7	− 1.1	−2.0	−0.9	0.5	30.7
Other investments(c)	33.5	− 0.4	—	−0.4	−0.9	32.7
	85.9	− 2.6	0.5	−0.8	1.1	83.0
Other industrial countries:						
Bank deposits	55.2	−1.3	0.2	2.0	..	54.6
Other investments(c)	71.8	−0.5	0.9	1.1	..	73.3
Offshore centres, bank deposits	36.0	0.3	−1.4	−0.4	..	34.5
OEC credit to non-banks(e)	7.7	0.3	—	0.3	..	8.3
IMF and IBRD(f)	20.7	1.0	0.1	−0.4	..	21.4
Placements with ldcs	58.3	—	1.0	—	..	59.3
Total identified additions(+)/reductions(−) in deployed assets	**391.8**	**−3.1**	**1.7**	**2.8**	..	**389.9**
Net funds available for deployment		1.0	4.9	−0.4	..	
of which:						
Net movements in external borrowing etc(g)		—	*0.6*	*−0.5*	..	
Current balance		*1.0*	*4.3*	*0.1*	..	

.. not available.

(a) The notes and definitions to Table 16 in the statistical annex of this issue gives a list of oil exporting countries.

(b) Provisional.

(c) Mainly loans and holdings of equities.

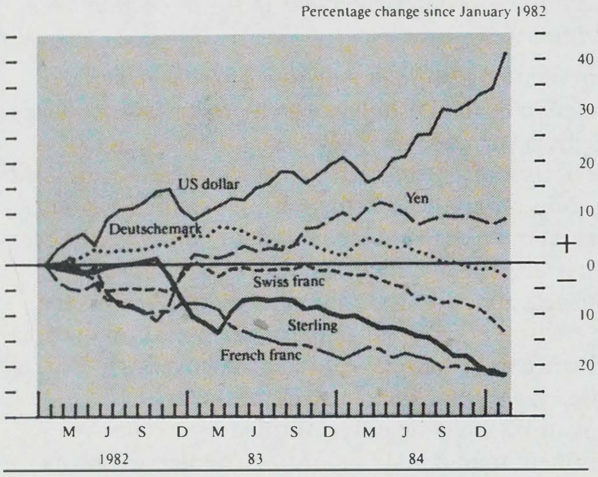
(d) United States figures still include Bahrain.

(e) Derived from data in *International Financial Statistics* but may overlap to a small extent with other items.

(f) Includes holdings of gold.

(g) Oil exporting countries' liabilities arising from net borrowing and inward direct investment, together with changes in credit given by them for oil exports.

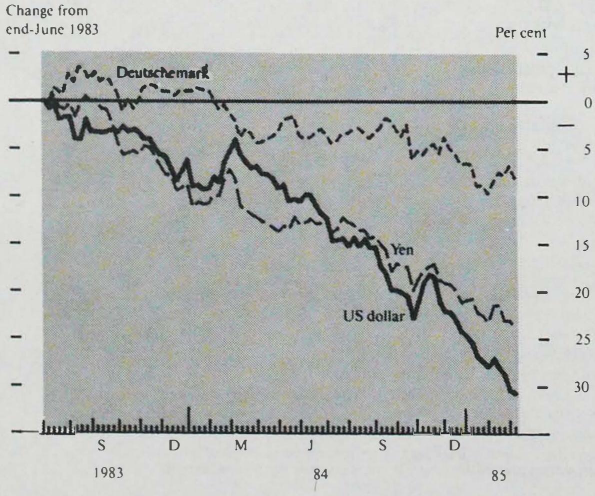
Indices of effective exchange rates



Chairman Volcker that central bank action might not have been forceful enough and that US budget and trade deficits would eventually weaken the dollar, it fell back sharply. After reported central bank intervention on 27 February, the dollar fell further to markedly lower levels, but began to rally by the end of the month.

Sterling suffered a sizable depreciation over the period, recording new lows against several major currencies, principally the dollar. Apart from the dollar's general strength, sterling's weakness was due chiefly to worries about oil prices, which were depressed by low demand as well as being undermined by uncertainty about OPEC's ability to maintain its pricing structure and levels. Sterling's vulnerability to such factors reflected the perceived importance of the oil sector to output, the balance of payments and government finances in the United Kingdom (particularly, in view of expectations that oil production would peak within a few years). The pound was also affected by market doubts about the Government's willingness to counter the depreciation of sterling, and in particular to sanction an increase in interest rates, reflecting the market feeling that recovery of output was being accorded a higher priority in the Government's economic strategy than budgetary and monetary discipline. The recent development of the broad

Sterling against selected foreign currencies



monetary aggregates reinforced these doubts. The market consequently came to regard the pound as a relatively risk-free target for speculation. Sterling's general fall was stemmed eventually by a series of three interest rate increases totalling 4½% which took commercial banks' base rates to 14%; and by the amelioration of oil price concerns following agreement in OPEC on a new pricing structure and a recovery in spot oil prices as a result of the exceptionally cold weather in February. Although sterling subsequently weakened further against the dollar, it remained firm against most other currencies until the last week of February when spot oil prices again eased. Record lows were registered against the dollar and in terms of the ERI, but sterling recovered some ground by the end of the period.

Sterling

The pound opened in London on 3 December at ERI 74.7, $1.1947 and DM 3.72½. The first part of the month provided a brief respite for sterling as concerns over the weakness of oil prices eased a little and it touched highs for the period of ERI 75.0 and $1.2160 on 5 December. Oil price concerns soon re-emerged as the market focused on the OPEC meeting which opened on 19 December. Sterling was also affected by the firming of the dollar. As trading conditions became increasingly thin ahead of the end-year holidays, sterling eased to touch new lows of ERI 72.7, $1.1632 and DM 3.62 on 20 December. Developments at the OPEC meeting and improved UK trade figures for November helped the pound to recover in London to reach ERI 73.6, $1.1765 and DM 3.67⅛ at the close of business on 24 December, but sterling's fall resumed after Christmas as thin trading persisted and it closed the month at ERI 73.0, $1.1580 and DM 3.65⅜.

While trading conditions improved somewhat in the new year, sterling remained under pressure against the background of oil price weakness and uncertainty. After a brief recovery to $1.1580 on 4 January, the pound fell back following a poor weekend press in advance of December's money supply figures. It continued to fall after these figures were released, perhaps because they turned out to be better than expected and expectations which had been built up of base rate increases were thereby disappointed. As a consequence, the pound again dropped below $1.14, touching a new low of $1.1370 in the Far East on 9 January. Sterling's weakness was exacerbated by further oil price anxieties ahead of OPEC's second meeting in January, called to try to tackle the problems left unresolved at its December meeting, and by increasing market doubts over the Government's willingness to defend the exchange rate. Little support was derived from a 1% increase in base rates (to 10½%), which had already been discounted by the time of its announcement on 11 January. The weekend press increased the uncertainty felt about the Government's exchange rate policy and a further new low of $1.1020 was set in the Far East on 14 January. Sterling opened in London at ERI 70.6, $1.1132, DM 3.52½ but, with the temporary reimposition of minimum lending rate at 12%, rebounded to \$1.1325. As the dollar strengthened and Statoil announced that Norwegian oil prices in January would be market related, the pound was forced down to ERI 70.8, \$1.1130, DM 3.54$\frac{7}{8}$ at the close on 14 January. It soon recovered to trade around \$1.1250, holding up quite well against persistent selling until 22 January when it dropped to \$1.1152 as the dollar firmed. Central bank intervention against the dollar sent the pound quickly up to \$1.1310, only to ease back on rumours of possible oil price cuts emanating from the OPEC meeting. With activity in the dollar/deutschemark market restricted by actual and expected intervention, speculation switched to sterling. The pound lost ground generally, dropping to \$1.1065 on 28 January, when the OPEC meeting seemed likely to break up in disarray. A 2% increase in base rates to 14% on 28 January stabilised sterling, which subsequently rallied strongly after news of agreement in OPEC. The pound achieved a high of \$1.1305 on 31 January, although short-lived expectations that base rates would be trimmed back immediately then took sterling down to close the month at ERI 71.6, \$1.1297 and DM 3.57$\frac{1}{2}$.

Once expectations of a reduction in base rates and a fall in oil prices had receded, sterling proved able to resist the dollar and regain some ground against Continental currencies until late on 8 February, when it slipped back following rumours that Nigeria was about to leave OPEC. Sterling selling continued in the following week and it touched a new low of \$1.0845 in late business on 12 February before recovering on news that BNOC would retain its official price for February. Sterling gave way to the strengthening dollar over much of the rest of the month, but held up well against other currencies until 26 February when it began to give way generally and set new lows of ERI 70.0 and \$1.0357 before closing at ERI 70.2, \$1.0420 and DM 3.61$\frac{1}{4}$. Pressure on sterling continued until the next morning when, after reports of central bank intervention against the dollar, the pound advanced in hectic trading, to touch highs of ERI 71.9 and \$1.1105, Sterling then eased back as the dollar recovered to finish the month at ERI 71.3 ($-4\frac{3}{4}$% over the period), \$1.0820 ($-10\frac{1}{8}$%) and DM 3.61$\frac{7}{8}$ ($-2\frac{7}{8}$%).

Official reserves

Over the three months to end-February, there was an underlying fall in the reserves of \$464 million. Net public sector borrowing under the exchange cover scheme totalled \$461 million, while \$122 million was repaid in respect of long-term North American loans. The reserves fell by \$18 million on account of the valuation adjustment arising from the quarterly roll-over of the European Monetary Co-operation Fund swap. At the end of February, the reserves stood at \$15,353 million.

Changes in UK official reserves

\$ millions

	1984 Dec.	1985 Jan.	Feb.
Change in reserves	**+198**	**−173**	**−168**
of which:			
Net borrowing (+)/ repayment (−) of public debt	+162	+127	+ 50
Valuation change on roll-over of EMCF swap	—	− 18	—
Underlying change in reserves	+ 36	−282	−218
Level of reserves (end of period)	**15,694**	**15,521**	**15,353**

US dollar

The dollar opened on 3 December at DM 3.1175, but immediately eased back to fluctuate erratically for a number of days in increasingly thin trading within the approximate range of DM 3.05 to DM 3.11. With the release in the second week of December of unexpectedly good US economic indicators, the dollar took on a much firmer tone. Its advance was briefly interrupted by reductions in US interest rates, including some prime rate cuts from 11$\frac{1}{4}$% to 10$\frac{3}{4}$% on 17 December. It eased back to touch DM 3.0832 on 19 December but, following the release of the fourth quarter GNP 'flash' estimate (+2.8%), the dollar rapidly resumed its advance against most major currencies. Further indicators were taken as confirming the market view that US economic growth was picking up again. A $\frac{1}{2}$% cut in the Federal Reserve's discount rate on 21 December had been largely anticipated and had little effect on the market.

The dollar climbed progressively to new highs against many currencies until fear of central bank intervention stalled it at DM 3.18 on 2 January. Thereafter, it fluctuated erratically between DM 3.13 and DM 3.18 until 14 January, when it broke out of this range, to achieve DM 3.1975 in Frankfurt. Despite $\frac{1}{4}$% cuts in US prime rates (to 10$\frac{1}{2}$%) on 14 January and some disappointing December economic indicators, the dollar only fell below DM 3.18 on 17 January after the Group of Five meeting, and touched a low the following morning in the Far East of DM 3.1540. After a brief recovery in London, where it closed at DM 3.1805, rumours of intervention quickly caused it to fall back in New York. Following remarks by President Reagan on the strength of the fourth quarter US GNP increase (+3.9%), the dollar moved up sharply again to reach DM 3.1845, but reported central bank intervention quickly forced the rate back down to close at DM 3.1683. Fear of further official intervention kept the dollar below DM 3.18 until 1 February, when it finally broke through this level in New York, to close there at DM 3.1957. A high M1 figure and a Federal Funds rate above 8$\frac{1}{2}$% confirmed market expectations of a possible tightening of US monetary policy and the dollar advanced to new record highs against all major currencies.

The market subsequently demonstrated some nervousness about new official action, notwithstanding Bundesbank President Poehl's remarks on the limited effectiveness of intervention; but this did not much affect the dollar's upwards progress until 14 February when it fell below DM 3.30 as dealers shortened positions, apprehensive that central banks might act on the US holiday on 18 February. But the dollar quickly resumed its advance, receiving support from President Reagan's remarks on 21 February rejecting any attempt to 'artificially' depress the dollar, which were interpreted as an indication that the Federal Reserve would not participate in further significant concerted action against the dollar, and a large upward revision to US GNP in the fourth quarter (from +3.9% to +4.9%). On 26 February, the dollar achieved record highs against all major currencies, including a 14-year high of DM 3.4790.

The dollar's advance was turned late on 26 February by rumours of central bank intervention following Chairman Volcker's testimony to the House Domestic Monetary Policy sub-committee that intervention might not have been forceful enough and that the US budget and trade deficits would ultimately undermine the dollar. Although the dollar recovered in the Far East on 27 February, reported central bank intervention later in the day forced it down to a low of DM 3.2700 (down some 16 pfennigs from the London opening). The dollar recovered, cautiously at first, to close on 27 February at DM 3.3400 and, despite further reported intervention on 28 February, moved up to finish the period at DM 3.3450, an appreciation of some 8% from end-November and in effective terms, a gain of $7\frac{3}{8}$% to 153.5.

EMS

The first signs of pressure for many months began to emerge within the EMS at the end of January as the narrow band widened (at times touching almost $2\frac{1}{4}$%). The Dutch guilder replaced the Belgian franc at the bottom of the system from 18 December: the Danish krone, remained at the top throughout the period. Over the period, the narrow band had widened by $\frac{7}{8}$% to 2%. The Italian lira, which operates within a 6% limit, remained within about $2\frac{1}{2}$% of other EMS currencies.

Other currencies

The yen became the subject of market pressure deflected first from the deutschemark by market apprehension of central bank intervention and then from sterling following the increase in UK base rates to 14%. It stabilised against the dollar somewhat in February, notwithstanding the dollar's general strength. Over the period as a whole, the yen depreciated by $4\frac{7}{8}$% to ¥259.56 and by $\frac{5}{8}$% in effective terms to 155.4.

The Swiss franc was subject to problems similar to those affecting the yen. It also reflected the lower level of Swiss interest rates and a policy of non-intervention in the foreign exchange markets by the Swiss authorities. Over the period, it fell by just over $12\frac{1}{8}$% to Sw.Fcs 2.8560 and by $5\frac{7}{8}$% in effective terms to 132.0.

Gold

The gold market was generally depressed by the strength of the dollar. The price fell particularly sharply in the second half of December and then fluctuated, generally just above $300, until late February, when it fell, touching $284.25 at the afternoon fix on 25 February. This was its lowest level since August 1979. Thereafter the price fluctuated narrowly, below $300. The final fixing of the period was $287.75, down $41.25.

London gold price