International financial developments

The US current account deficit reached $100 billion in 1984 and continued unabated into the first quarter of 1985; Japan's surplus was about a third of this size while other major economies remained broadly in balance. The higher overall deficit of the major countries found its counterpart primarily in much reduced deficits of the non-oil developing countries. Developing countries have maintained their concessionary and official borrowing and have built up reserves; during 1984 they became the principal net suppliers of funds to the international banking system.

Changes in the composition and preferences of borrowers and investors since the debt crisis, together with liberalisation and competition, have shifted the focus of international capital markets towards transferable forms of lending. Thus the capital inflow financing the US current deficit towards the end of last year increasingly took the form of portfolio investment—for example in corporate eurobond issues—and was partially matched by Japanese portfolio outflows. Announcements of syndicated credits fell in the first quarter of 1985 to their lowest for ten years—and growing amounts are in transferable form.

In the foreign exchange markets the dollar has retreated from its February peaks. Sterling has recovered much of the ground it lost last autumn and winter.

World current account positions

The combined current account deficit of the *major seven economies,* which was reduced substantially in the last quarter of 1984, rose sharply again in the first quarter of this year to levels seen last summer. The rise was largely accounted for by the United States where import growth in the fourth quarter had been depressed by a slower rate of stockbuilding. This year, growth in US domestic demand has been stronger than in the final quarter of 1984 and largely satisfied by imports. In the major continental European countries exceptionally bad weather may have contributed to higher energy imports early this year, and thereby to a general deterioration in current account positions which was exacerbated by adverse terms of trade movements. The UK current account returned to balance in the first quarter of this year after a modest surplus in the last quarter of 1984, while in Japan an increase in the current account surplus in the final quarter of last year does not appear to have continued into 1985.

The *smaller OECD economies'* combined current account deficit narrowed a little in 1984. Restrictive policies in most of these countries, aimed at correcting structural imbalances, contributed to the stronger current accounts; although in certain countries, most notably Australia, faster than average growth contributed to a deterioration in the current account position.

The combined current account deficit of the *oil exporting countries* showed a marked improvement overall in 1984, moving into modest surplus after sizable deficits in 1982 and 1983. This improvement largely reflected a substantial cut-back in import volume: export growth was depressed by weak oil market conditions.

World current accounts[a]

$ billions: *seasonally adjusted*

	1983	1984				1985
	Year	Year(b)	Q2	Q3	Q4(b)	Q1(b)
OECD economies:						
Canada	1	2	—	1	1	—
France	− 5	—	− 1	1	1	− 1
Germany	4	6	—	2	4	2
Italy	1	− 3	− 1	—	− 1	− 2
Japan	21	35	9	7	11	9
United Kingdom	5	1	− 1	− 1	1	—
United States	−42	−102	−24	−34	−24	−31
Major economies	−15	− 60	−17	−24	− 9	−23
Other OECD	− 8	− 5	− 2	− 2	− 2	..
Total OECD	−23	− 65	−19	−25	−10	..
Oil exporting economies	−13	5	1	2	1	..
Other developing economies	−39	− 18	− 5	− 4	− 3	..
Other economies(c)	2	1	—	—	—	..
World discrepancy(d)	−73	− 80	−23	−28	−12	..

.. 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.

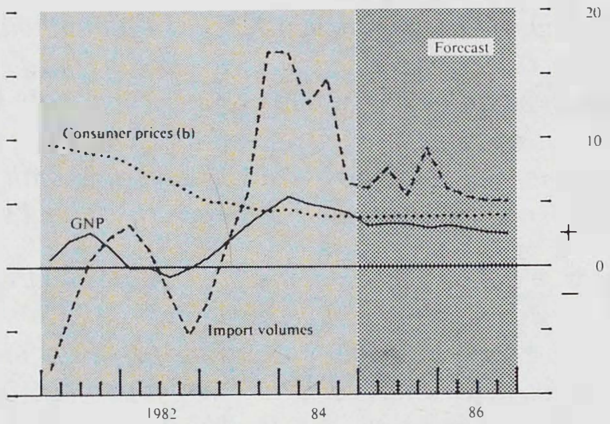
(d) Reflecting errors and omissions arising from incomplete coverage, timing differences and other statistical deficiencies.

In the fourth quarter of 1984 the current account deficit of the *non-oil developing countries* remained at $4 billion (not seasonally adjusted), roughly unchanged from the third quarter. With world trade slowing down in the fourth quarter, both import and export volumes stabilised at about their third quarter levels, having risen steadily in the first half of the year. The invisibles deficit of these countries is thought to have continued its recent gradual decline. Thus the current account deficit is estimated to have been reduced from $39 billion in 1983 to $18 billion

World economic prospects—latest Bank forecasts

Output in the major seven industrial countries is expected to grow by around 3¼% this year and to slow a little further, to perhaps 2¾%, in 1986. This deceleration entirely reflects projected developments in North America: growth in the United States is forecast to average around 3% in 1985 and 2% in 1986; in Japan and in the major continental European economies, activity is thought likely to stabilise or accelerate slightly, with growth of around 4½% and 2½% respectively in 1985 and 5% and 3% in 1986. The continuing expansion of output in the major countries suggests world trade growth of about 5% per annum over the next two years, with further benefit to the developing countries and some of the smaller industrial countries. Inflation in the major industrial countries in aggregate is unlikely to rise significantly and in continental Europe it should fall further, assisted by the maintenance of generally tight monetary and fiscal policies and by expected further falls in real oil and commodity prices.

Prices, GNP and trade growth in the major seven economies[a]



(a) Canada, France, Germany, Italy, Japan, United Kingdom and United States.
(b) Consumers' expenditure deflators.

Demand and output in the seven major economies[(a)]
Percentage changes

	1982	1983	1984	Forecasts 1985	1986
Domestic demand	**0.1**	**2.9**	**5.2**	**3.4**	**2.8**
of which:					
Private consumption	1.4	3.3	3.3	3.3	2.8
Private fixed investment	-3.3	3.4	9.2	5.8	4.7
Public expenditure	1.6	0.8	2.1	3.0	1.9
Stockbuilding(b)	-0.5	0.2	1.1	-0.2	-0.2
Net trade(b)	-0.3	-0.2	-0.3	-0.2	0.1
GNP(c)	**-0.3**	**2.7**	**4.9**	**3.2**	**2.9**

(a) Canada, France, Germany, Italy, Japan, United Kingdom, and United States.
(b) Percentage contribution to GNP or GDP.
(c) Or GDP.

In the United States, activity has already slowed and over the next two years domestic demand is likely to be further restrained by a less expansionary fiscal stance and a cyclical reduction in stockbuilding. Consumers' expenditure may also be constrained by slow growth in real earnings (though this may encourage investment and employment growth in the medium term). Net imports are again likely to hold back output growth, reflecting past losses of competitiveness as the dollar appreciated. On the other hand some cyclical catching-up in competitor countries should reduce the adverse impact of net trade on US output, especially next year; any substantial depreciation of the US dollar would reinforce this tendency.

The forecast acceleration of activity in continental Europe next year mainly reflects projected developments in Germany as domestic demand (in particular consumer spending) is stimulated by a further reduction in the already low inflation rate and by tax cuts already announced, while net trade should continue to benefit from past improvements in competitiveness. Consumer spending may also accelerate somewhat in France and Italy. Profitability is forecast to improve, but from very depressed levels, and business investment in continental Europe may grow at around 5%–6% per annum. Thus, although GNP growth rates in the major industrial countries are expected to converge during 1985 and 1986, the basis of the European recovery remains rather fragile.

Unemployment in the major industrial countries as a whole fell from 8.6% in 1983 to 7.8% last year (solely as a result of reductions in North America) but may not fall further in 1985 and 1986. Earnings seem unlikely to accelerate much and, despite some cyclical slowing of productivity growth, manufacturers' unit labour costs are expected to continue rising by less than 3% per annum. As a result of this and a likely further small fall in commodity prices in real terms, inflation should remain subdued. Overall, consumer prices in the main industrial countries should continue to rise at around 4% per annum, with a further reduction in continental Europe balanced by some slight rise in North America.

Despite fears of mounting protectionism, world trade grew by almost 9% last year. This is expected to slow to around 5% per annum in 1985–86 as US activity slows but it should still enable the developing countries to achieve export volume growth of 6%–7% per annum. Several of the smaller industrial countries should also benefit but the oil exporting countries are expected to remain constrained by weak demand for their oil. UK markets seem likely to continue to grow by rather less than world trade.

World trade and UK markets
Percentage changes

	1982	1983	1984	Forecasts 1985	1986
World trade	-1.0	1.6	8.7	5.5	4.6
UK markets	0.1	0.2	6.4	3.8	3.8

Developing countries' balance of payments
$ billions; *not seasonally adjusted*

	1983	1984(a)				
	Year	Year	Q1	Q2	Q3	Q4
Current account	**−39**	**−18**	**− 6**	**− 4**	**− 4**	**−4**
Capital account	**29**	**29**	**7**	**7**	**6**	**8**
of which:						
Concessionary and other official flows	24	26	6	6	7	7
Direct investment	8	9	2	2	2	2
Borrowing from banks(b)	12	9	1	3	1	4
Borrowing via bond issues	2	2	—	—	—	1
Other capital flows(c)	−17	−17	− 2	− 4	− 5	−5
Official financing balance	**11**	**−11**	**− 1**	**− 3**	**− 2**	**−4**
of which:						
Use of IMF credit	10	5	1	2	1	1
Liabilities to other CMIs	5	—	—	—	—	1
Reserves etc (increase −)	− 4	−15	− 2	− 5	− 2	−5

(a) Includes Bank estimates.
(b) Adjusted to exclude valuation effects.
(c) Includes net errors and omissions.

in 1984. This reduction reflects the continued adjustment efforts of many countries: for instance, Brazil's current account deficit was cut to $0.5 billion (compared with $16 billion in 1982 and $7 billion in 1983); Mexico's current account surplus was down slightly at $4 billion (from $5 billion in 1983, after deficits of $14 billion and $6 billion in 1981 and 1982 respectively).

Prospects for growth in the world economy and world trade are discussed on page 198.

Capital movements

Capital inflows to the *non-oil developing countries* in aggregate have continued to be more than sufficient to cover current deficits, allowing a substantial buildup of reserves in many countries. Borrowing from banks picked up in the last quarter of 1984 bringing the annual total to almost $9 billion with much of the spontaneous lending going to Far Eastern countries. Far Eastern countries were also able to raise finance through the increasing volume of bond issues and this has continued into the first quarter of 1985. Direct investment, concessionary lending and other official flows continued to increase through 1984 but concessionary lending by multilateral institutions is thought to have fallen back in the early part of 1985.

The *oil exporting countries* increased their external borrowing somewhat in the last quarter of 1984 as their overall current account position deteriorated. Over the year as a whole their estimated current account surplus together with net external borrowing would suggest funds totalling some $6½ billion were available for deployment. Identified movements in oil exporters' assets, however, broadly cancel out, leaving the bulk of this total unidentified. Bank deposits, which in 1982 and 1983 had fallen markedly (by almost $24 billion in total), increased modestly during 1984, by some $3 billion. On the other hand, holdings of government paper continued to decline (by $4 billion), mostly in the United States, although the fall was less marked than in the previous year. Holdings of other investments fell in both the United Kingdom and the United States but on the whole showed steady growth in the remaining industrial countries, as the process of portfolio diversification continued.

A sharp fall in eurocurrency deposits in the United Kingdom in the fourth quarter of 1984 was largely offset by a rise in bank deposits elsewhere. Holdings of government paper in the United States grew in the fourth quarter, for the first time since the end of 1982, and this growth appears to have continued, albeit more modestly, in the first quarter of 1985.

Capital flows to and from the *major industrial economies* in 1984 were dominated by the US capital account surplus. The strong net inflows to the United States through the banking system in 1983 and early 1984, which were primarily a consequence of the reduction in US banks' lending to the non-oil developing countries, were superseded in importance in the fourth quarter by a large increase in portfolio investment. (Following the abolition of US withholding tax, there was a surge in issues on the eurobond market by US corporations yielding a net inflow of $8.6 billion in the quarter.) Some counterpart to the flow of portfolio investment to the United States may be found in an exceptionally strong outflow of portfolio investment from Japan (over $11 billion in Q4).

Increased competition between countries for mobile capital funds has been a recent feature. France, Germany,

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

	Dec. 1983 levels	1984				Dec. 1984 levels	1985
		Q1	Q2	Q3	Q4		Q1(b)
United Kingdom:							
Sterling bank deposits	4.9	0.1	0.5	0.2	0.1	4.6	−0.1
Eurocurrency bank deposits	43.9	−0.2	0.4	0.8	−2.9	41.3	—
British government stocks	3.4	−0.1	−0.3	0.1	−0.2	2.2	−0.1
Equities, loans etc	5.7	−0.1	−0.2	−0.2	—	5.0	−0.1
	57.9	−0.3	0.4	0.9	−3.0	53.1	−0.3
United States:(c)							
Bank deposits	17.7	−1.1	2.5	0.5	1.6	21.2	−0.2
Treasury bonds, notes and bills	34.7	−1.1	−2.0	−0.9	0.5	31.2	0.2
Equities, loans etc	33.5	−0.4	—	−2.1	−0.2	30.8	−0.4
	85.9	−2.6	0.5	−2.5	1.9	83.2	−0.4
Other industrial countries:							
Bank deposits	56.6	−1.3	0.2	2.0	0.3	56.0	. .
Equities, loans etc	71.8	−0.4	0.9	1.1	1.2(b)	74.4(b)	. .
Offshore centres:							
Bank deposits	36.0	0.4	−1.2	−0.2	0.5	35.5	. .
OEC credit to non-banks	7.7	0.3	—	0.3	—(b)	8.3(b)	. .
IMF and IBRD(d)	35.9	1.0	0.2	−0.5	−1.1	32.3	. .
Placements with ldcs	58.3	—	0.9	−0.1	0.3	59.5	. .
Total identified additions(+)/reductions (−) in deployed assets	**410.1**	**−2.9**	**1.9**	**1.0**	**0.1**	**402.3**	. .
Net funds available for deployment		1.3	4.7	−0.3	0.9		
of which:							
Net movements in external borrowing etc(e)		*0.3*	*0.4*	*−0.4*	*1.4*		
Current balance		*1.0*	*4.3*	*0.1*	*−0.5*		

. . not available.

(a) The notes and definitions to Table 16 in the statistical annex of the March *Bulletin* gives a list of oil exporting countries.
(b) Provisional.
(c) United States figures still include Bahrain.
(d) Includes holdings of gold, valued at end-period market prices for levels and average prices for flows.
(e) Oil exporting countries' liabilities arising from net borrowing and inward direct investment, together with changes in credit given by them for oil exports.

and the United States all abolished withholding tax. There has been some easing in exchange controls in France, and also in Italy; and measures have come into effect in Germany to liberalise capital markets and to encourage the greater use of the deutschemark as a reserve currency and the development of Frankfurt as a financial centre.

The *UK capital account* in the first quarter of 1985 showed net identified outflows of £1.0 billion. Larger than usual flows of direct investment reflected major acquisitions. Overseas portfolio investment by non-bank financial institutions was higher than the recent trends. This investment outflow was largely offset by a substantial net inflow of sterling deposits from overseas: a rise in overseas sterling deposits of £4.4 billion being only partly offset by a £3.0 billion rise in UK banks' sterling loans to overseas.

International capital markets

The trends in international capital markets evident in 1984 continued into the first half of 1985. Japan, Germany and France took a number of measures which will widen international use of their markets and currencies. Similar measures had been taken by these and other countries during 1984, which, over time, could have widespread implications for the relationship between domestic and international markets, the location and currency in which international business is conducted and official control of, and operations in, national and international markets. As yet it is too early to assess the impact of this liberalisation process.

The shift towards lending in marketable form has also been maintained with issues of fixed and floating-rate securities far exceeding announced syndicated credits. A growing proportion of the declining volume of credits is being arranged in transferable form. At the same time, the market for note issuance and related facilities continues to grow and is evolving at a rapid pace, offering borrowers increasing flexibility through a wide choice of drawing options. The range of borrowers using the market has also expanded, and corporate borrowers from major OECD countries have become important users.

OECD borrowers continue to take an increasing share of international borrowings with those from the United States and Japan most prominent. Eastern European borrowers have been returning to the markets. A notable feature this year has been the use of the FRN market by British banks to raise primary capital in a form which would rank as preference shares in the event of liquidation. Terms for favoured borrowers remain good as the very low margins reached during 1984 have been maintained. Refinancings, to take advantage of these favourable terms, have continued at about the same rate as in 1984.

Fixed-rate bonds

Fixed-rate bond issues continued at a high rate in the first part of 1985. Some $24 billion of issues was completed in the first quarter, and $12.5 billion in April and May. A surge of announcements of issues in dollars, yen and deutschemarks in January and February was followed by a period of much lower activity with the market oversupplied and, at least in the dollar sector, affected by interest and exchange rate uncertainty.

US borrowers maintained their dominant position, accounting for a third of the total issues in the first quarter even before the $1 billion issue in early June by the US Treasury aimed at foreign investors. Issues by Japanese borrowers rose sharply, with a recovery in convertibles and a surge of straight fixed-rate eurodollar bonds aimed at Japanese institutional investors. Canadian borrowers were also particularly active in the first quarter. A fixed-rate eurobond for Hungary was the first for that country since 1977, and a DM 150 million bond for the Bank of China announced in May was the first for China.

The yen maintained a 12% share of the market in the first five months of 1985. After a surge of issues in December and January following liberalisation measures which came into effect on 1 December, the euroyen market was quiet in February and March apparently because of disenchantment with the tight terms on the part of investors and a shortage of swap counterparties. The 20% withholding tax payable by Japanese companies on bond issues sold to foreign residents was repealed from 1 April and thereafter a number of Japanese companies issued euroyen convertibles. In April the yen took a 20% share of the market. April saw the first euro French franc issues for four years when this market was reopened by the French authorities.

Floating-rate notes

FRN issues fell back sharply at the start of the year and despite a subsequent pickup failed in the first quarter of 1985 to maintain the high level of the fourth quarter of 1984: they fell by 14% to $10 billion. About one third of

Completed international bond issues[a]
$ billions; *percentages in italics*

	1984			1985		
	Q2	Q3	Q4	Q1	Apr.	May
Fixed-coupon bonds						
Borrower:						
Major OECD countries	7.9	10.1	14.6	17.5	3.5	3.4
of which:						
United States	1.9	3.8	8.0	8.1	0.9	1.9
Japan	3.3	3.5	2.9	5.6	1.3	0.8
Minor OECD countries	3.0	2.9	4.1	3.3	1.4	1.6
International institutions	2.2	3.0	4.2	3.1	1.2	0.7
Other	0.5	0.5	0.6	0.5	0.4	0.2
Total	**13.6**	**16.5**	**23.5**	**24.4**	**6.5**	**5.9**
Currency:						
US dollars	*36.2*	*52.6*	*56.3*	*54.7*	*28.8*	*54.0*
Swiss francs	*27.2*	*17.0*	*9.8*	*12.8*	*8.3*	*10.8*
Yen	*11.2*	*7.6*	*10.0*	*9.8*	*19.9*	*9.9*
Other	*25.4*	*22.8*	*23.9*	*22.7*	*43.0*	*25.3*
Floating-rate notes						
Borrower:						
Major OECD	3.1	5.7	7.2	7.0	2.3	2.6
Minor OECD	2.6	2.0	2.8	1.5	1.4	0.9
Other	0.2	0.4	1.4	1.5	1.0	0.6
Total	**6.0**	**8.1**	**11.4**	**10.0**	**4.7**	**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.

these issues incorporated a mismatched pricing structure allowing investors to benefit from the steep dollar yield curve. The main reason for the fall was the absence of issues by British banks, following the Bank of England's November 1984 guidelines on the supervisory treatment of FRNs issued as capital. Other nationalities of bank maintained their presence.

In May, British banks returned to the market announcing issues of $3 billion (not completed by end-May) of perpetual FRNs which in the event of liquidation would rank as preference shares available to absorb losses, thereby meeting the essential objectives of the Bank's requirements for primary capital. Concerns that the new features needed to satisfy the Bank's requirements would make the perpetual instruments unattractive to investors proved unfounded. The terms were at least as good as those which had applied to previous perpetual notes issued by British banks during 1984.

Issues by public sector borrowers were particularly low in the first quarter, but picked up in April and May with large issues for borrowers from a number of countries including Sweden, Malaysia, Italy and Algeria. In May the European Community announced a $1.8 billion FRN issue to refinance an issue dating from 1983. The deutschemark sector was liberalised from the beginning of May to permit FRNs and zero-coupon bonds. Subsequent issues included a DM 1.5 billion FRN issue for Sweden.

Note issuance facilities

The banks' willingness to underwrite note issuance and similar facilities was perceived to be waning at the start of the year because of low fees and supervisory concerns about such business. Nevertheless, such facilities continued to be granted at much the same rate as in the second half of 1984 with $6.7 billion of facilities announced in the first quarter and $8.4 billion in April and May. A large proportion of facilities continued to be for borrowers from OECD countries, principally the United States and Australia, while non-bank corporations became major borrowers.

As with other facilities, the value of note issuance facilities arranged may be a misleading guide to actual lending. Of around $40 billion of facilities in place it seems likely that only some 10%–20% has so far been drawn; many facilities are arranged as standbys only.

The market continues to evolve rapidly with some signs that it may develop into a euromarket in commercial paper; during the period an increasing number of facilities were only partly underwritten and for the first time euronotes received a rating from Standard and Poor's. Facilities are also becoming increasingly sophisticated, offering the borrower a growing range of borrowing options—including the issue of promissory notes, letters of credit, bankers' acceptances, commercial paper, swing lines and short-term advances—and a widening choice of interest rate bases and currencies.

Announced note issuance facilities:[a] analysis of borrowers

$ billions

	Major OECD	Minor OECD	Other	**Total**	*of which:* *Industrial*	*Financial*	*Government*
1982(b)	0.13	0.29	0.17	**0.59**	*0.27*	*0.17*	*0.15*
1983(b)	0.43	0.31	0.08	**0.82**	*0.38*	*0.44*	—
1984(b)	1.60	2.80	0.32	**4.72**	*1.89*	*0.93*	*1.90*
1984 Q2	0.69	5.70	—	**6.39**	*0.40*	*0.49*	*5.50*
Q3	0.80	2.98	0.21	**3.99**	*1.43*	*1.06*	*1.50*
Q4	4.79	2.31	0.92	**8.02**	*5.58*	*1.84*	*0.60*(c)
1985 Q1	4.12	2.25	0.30	**6.67**	*4.87*	*1.30*	*0.50*
1985 Apr.	3.45	0.69	0.43	**4.57**	*3.79*	*0.38*	*0.40*
May	2.61	0.65	0.59	**3.85**	*2.60*	*1.25*	—

(a) These data were formerly compiled on a completions basis. Note issuance facilities is used as a generic term encompassing revolving underwriting facilities, note purchase facilities, and euronote facilities. Earlier data have been revised to include multiple component facilities which incorporate a note issuance option.

(b) Quarterly average.

(c) Includes $500 million for international institutions.

Until recently note issuance facilities have been arranged almost exclusively in dollars: many of the alternative options available under multiple component facilities have been included to make other currencies available to borrowers. Several recent facilities have included an option for the issue of sterling notes. This was made possible by the order under the UK Banking Act, announced in March, that allows non-bank borrowers, under certain conditions, to make regular issues of sterling bonds with a maturity of between one and five years.

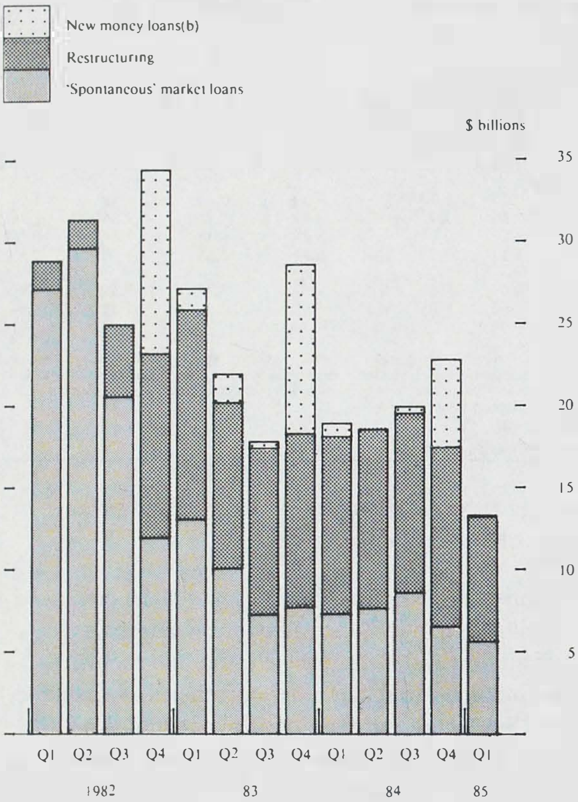
In early April, the Bank announced arrangements for including banks' underwriting obligations under note issuance facilities in the measurement and assessment of capital adequacy. As a provisional measure, pending the completion of a wide-ranging review of off balance sheet risks, such obligations will be treated as contingent liabilities for purposes of assessing capital adequacy and will be included at a weight of 0.5 (half the weight accorded to normal commercial lending) in the calculation of the risk asset ratio, whether or not the facility has been drawn down by the borrower. Shortly afterwards the Japanese authorities announced their intention to accord these obligations a 0.3 risk weight (equivalent to 30% of the weight applied to normal commercial lending). It is too early to assess the full impact of these measures on the volume of facilities arranged or on terms.

Medium-term syndicated bank credits

Announcements of syndicated credits declined in the first quarter of 1985 to only $5.6 billion, the lowest level since 1975. They remained low in April and May. Banks' commitments under rescheduling and new money packages were also much lower than in recent quarters, totalling only $7.7 billion in the first quarter.

An increasing number of new credits were in transferable form. Ten such facilities totalling $1.5 billion were announced during the first quarter, as much as in the whole of 1984, and in May Korea Development Bank announced the largest such facility to date, for $600 million. The dollar's share of total borrowing fell

Announced syndicated lending[a]



(a) Restructured loans are spread evenly over the quarters in which repayments of principal would otherwise have fallen due. New money and market loans are allocated to the quarters in which they were announced.

(b) Additional bank loans made in association with restructuring arrangements.

slightly (from an average of 87% in 1984 to 76% in the first quarter of 1985) while that of the ECU rose (from 7% in 1984 to 14%). The first euroyen credits were announced following liberalisation measures by the Japanese authorities which came into effect on 1 April, but only after one planned credit had been withdrawn because of lack of support.

Terms and conditions continued to improve for most borrowers, with Eastern bloc borrowers securing the greatest improvement. Few new loans were announced for borrowers from OECD countries, although borrowers from several were active in renegotiating or refinancing existing loans. New credits for developing countries totalled $1.2 billion in the first quarter of 1985 and $1.0 billion in April and May.

'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	**8.61**	3.57	1.85	3.19	*0.78*	*1.62*	*0.58*
Q4	**6.55**	1.12	1.71	3.72	*1.60*	*1.48*	*0.60*
1985 Q1	**5.64**	1.70	1.66	2.28	*0.37*	*1.20*	*0.64*
Apr.	**1.48**	0.40	0.39	0.69	*0.10*	*0.33*	*0.26*
May	**2.80**	0.30	0.65	1.85	*0.10*	*0.75*	*1.00*

(a) Quarterly average.

International banking developments

This section examines the activities of banks in the BIS reporting area in the fourth quarter of 1984 and of banks in the United Kingdom in the first quarter of 1985. Banks located in the United Kingdom account for around one quarter of total international lending by banks so that statistics for the London market provide an important and early source on developments in international banking. The relationship between the banking statistics and the international capital markets data covered in the preceding section is discussed in the March *Bulletin*, page 64.

Banks in the BIS reporting area (fourth quarter of 1984)
External and international lending by banks in the BIS area picked up in the fourth quarter of 1984 after the very depressed third quarter. Most of the strength was in interbank lending within the reporting area, and largely represented the seasonal balance sheet expansion of Continental banks. Identified lending to final users, although stronger than in the third quarter, was no higher than in the first half of 1984. However, the fourth quarter recovery was probably rather stronger than these banking statistics suggest as they exclude part of banks' purchases of fixed and floating-rate notes and bonds, issues of which rose very rapidly in the final months of 1984.

External business of banks in the BIS reporting area

$ billions; changes exclude estimated exchange rate effects

	1983	1984			Outstanding at end-Dec.
	Year	Year	Q3	Q4	1984
Deposits from					
Outside reporting area:					
Offshore banking centres	+31	+1	+1	+1	46
Developed countries	+2	+5	+1	+2	30
Eastern Europe	+3	+4	+1	+1	22
Oil exporting countries	−14	+3	+3	—	141
Non-oil developing countries	+10	+22	+2	+7	171
of which, Latin America	*+6*	*+11*	*+3*	*+3*	*69*
Sub-total	+32	+35	+8	+11	410
Inside reporting area	+74	+116	−7	+45	1,660
Unallocated	+4	−1	+3	−6	47
Total	**+111**	**+149**	**+4**	**+51**	**2,117**
Lending to					
Outside reporting area:					
Offshore banking centres	+18	−1	−1	+1	46
Developed countries	+7	+8	+2	+1	90
Eastern Europe	−1	+1	—	+1	49
Oil exporting countries	+10	—	−2	+2	106
Non-oil developing countries	+12	+9	+1	+4	329
of which, Latin America	*+8*	*+4*	—	—	211
Sub-total	+45	+16	+1	+8	619
Inside reporting area	+56	+112	−5	+47	1,501
Unallocated	+4	−1	−1	+1	34
Total	**+105**	**+126**	**−5**	**+55**	**2,154**

Lending to countries outside the BIS area accelerated in the fourth quarter, as usual, but was highly concentrated, with over two thirds of the credits going to six countries. Bank lending to Latin America fell for the first time in two years, despite further drawings of new money provided under support packages. US dollar denominated lending recovered in the fourth quarter, accounting for over half the rise in external lending for which currency information is available; dollar lending had contracted in the third quarter as banks in the United States reduced their balance sheets. Even so, lending in currencies other than the US dollar continued to rise. Lending in deutschemarks (the second most important currency for international lending) rose strongly in the fourth quarter and ECU-denominated loans again proved popular. The pace of sterling denominated lending also picked up in the final quarter, so that in the year as a whole both eurosterling and sterling lending from London to overseas grew quite strongly; most of this growth was in the interbank market.

Outside-area countries again increased their deposits with BIS-area banks substantially in the final quarter of 1984; these countries were net suppliers of funds for the fourth consecutive quarter. In the fourth quarter and the year as a whole the non-oil developing countries were the principal net suppliers.

The BIS has published data for the first time showing the international business of BIS-area banks on a bank nationality rather than the usual financial centre basis. These show that, in 1984 as a whole, the increase in all banks' international claims was more than accounted for by the expansion of Japanese banks' business worldwide. In contrast, the international assets of US banks based throughout the BIS area contracted sharply, principally in the second half of the year.

The London market (first quarter of 1985)
The international lending of banks in the United Kingdom recovered in the first quarter of 1985 after very slow growth in the second half of last year. The external lending which can be traced geographically (ie excluding purchases of investments) again went principally to other BIS-area countries, with just under one half going to the United States.

Lending to the non-oil developing countries fell by over $1 billion, offsetting two thirds of the rise in 1984. Half of the first quarter fall reflected the reduction in claims on Mexico. Deposits from the non-oil developing countries also fell in the first quarter, but less steeply than their borrowing, and these countries in total were again net suppliers of funds to banks in the United Kingdom.

Within the overall increase in external deposits, private sterling deposits grew particularly rapidly; in contrast, official holdings fell slightly. Restrictions on official sterling balances were lifted on 18 December 1984.

External business of banks in the United Kingdom

$ billions; changes exclude estimated exchange rate effects

	1984					1985
	Year	Q1	Q2	Q3	Q4	Q1
Deposits from:						
BIS reporting area(a)	+25.1	+ 9.3	+11.0	−0.6	+5.4	+12.5
Offshore banking centres(b)	+ 7.4	+ 6.3	− 0.2	+0.1	+1.2	+ 2.5
Sub-total	+32.5	+15.5	+10.8	−0.5	+6.6	+15.0
Other Western Europe	− 1.4	− 0.1	+ 0.5	+0.6	+0.4	+ 0.2
Australia, New Zealand and South Africa	+ 0.2	+ 0.1	—	—	+0.1	+ 0.1
Eastern Europe	+ 0.9	+ 0.4	− 0.1	−0.6	+1.2	− 0.8
Oil exporting countries	− 1.1	− 0.1	+ 0.9	+1.0	−2.9	—
Non-oil developing countries	+ 4.7	+ 2.5	+ 2.7	−1.9	+1.4	− 0.6
Others(b)	− 2.5	+ 0.3	− 2.3	−0.8	+0.3	− 0.2
Sub-total	+ 3.6	+ 3.1	+ 1.7	−1.7	+0.5	− 1.3
Total	**+36.1**	**+18.7**	**+12.5**	**−2.2**	**+7.1**	**+13.7**
Lending to:						
BIS reporting area(a)	+16.6	+14.4	+ 0.1	−3.4	+5.5	+ 8.6
Offshore banking centres(b)	+ 8.9	+ 0.2	+ 8.9	+1.4	−1.6	+ 1.0
Sub-total	+25.5	+14.6	+ 9.0	−2.0	+3.9	+ 9.6
Other Western Europe	+ 0.4	—	−0.1	+0.3	+0.2	+ 0.2
Australia, New Zealand and South Africa	+ 0.8	+ 0.2	+ 0.5	−0.1	+0.2	+ 0.4
Eastern Europe	− 0.4	− 0.1	− 0.2	—	−0.1	− 0.1
Oil exporting countries	− 1.0	− 0.1	+ 0.7	−0.9	−0.7	+ 0.2
Non-oil developing countries	+ 1.7	+ 0.7	+ 1.0	−0.4	+0.4	− 1.2
Others(b)	− 0.3	− 0.3	+ 0.6	−0.7	+0.1	—
Sub-total	+ 1.2	+ 0.4	+ 2.5	−1.8	+0.1	− 0.5
Total	**+26.7**	**+15.0**	**+11.5**	**−3.8**	**+4.0**	**+ 9.1**

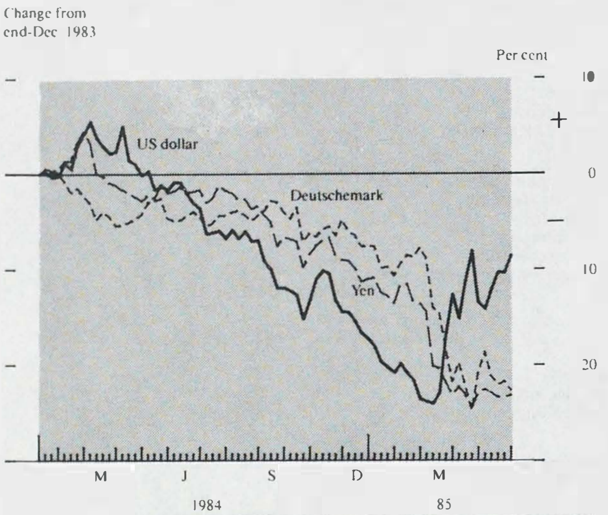
(a) Excluding offshore reporters.
(b) Including BIS reporters and other offshore centres.

Foreign exchange and gold markets

This section reviews the three months to end-May.
The most notable developments of the period were the retreat of the dollar from the record peaks attained in February and the recovery of sterling. The dollar's fall followed closely the heavy concerted central bank intervention earlier this year. With the markets apprehensive over further official action, confidence that the dollar would continue to rise was weakened and doubts were reinforced by emerging evidence that US economic growth might be slowing down. There were also renewed concerns about the health of various parts of the US financial system. Nevertheless, despite signs of weakness in the economic indicators, underlying support for the dollar, particularly in the United States, remained in evidence and demand re-emerged at lower levels. Growing uncertainty over the dollar's longer-term trend at times gave rise to frequently thin and volatile trading conditions and erratic exchange rate movements. These circumstances also appeared to produce strong reactions when the dollar breached, or failed to breach, certain key exchange rates against the deutschemark. The dollar's fall was therefore somewhat hesitant and repeatedly interrupted at important 'chart points' from which it made a number of rallies. In May, the dollar traded more narrowly, below DM 3.12 but above the psychologically important DM 3 level, fluctuating largely in reaction to the release of a series of contradictory US economic and monetary indicators. It was able to absorb, with only temporary impact, reductions in the Federal Reserve discount rate and US banks' prime rates towards the end of the period.

Sterling
Sterling staged a recovery over the period, making up much of the ground it had lost over the previous months. Part of this recovery was due to the easing of the dollar but sizable gains were also made against the Continental currencies. The favourable market response to the Budget and firmer spot oil prices were a factor early in the period but the continuing factor favouring sterling was the relatively high level of UK interest rates which, despite a series of modest reductions in UK banks' base rates (totalling $1\frac{1}{4}\%$–$1\frac{1}{2}\%$), were expected to remain firm. Sterling was unable to sustain itself above the $1.30 level, however, and also met increased selling above about DM 3.90. Its generally firm performance was also punctuated by the re-emergence of oil price concerns.

Sterling against selected foreign currencies



The pound opened the period on 1 March on a somewhat soft note at ERI 70.9, \$1.0785 and DM 3.5930 in London. It received a brief boost on 4 March from the news of the end of the coal strike but, as the dollar recovered after central banks were seen to have ceased heavy intervention and profits were taken on the recent gains against the Continental currencies, the pound soon fell back to a low of \$1.05 on 6 March. Sterling then rallied briefly but quickly slipped back again; there was, however, little specific reaction to the announcement on 13 March that the British National Oil Corporation (BNOC) would be abolished. As the dollar weakened, sterling quickly recovered, firming particularly sharply ahead of the Budget, and it continued to strengthen thereafter with the market reassured about the Government's commitment to a strict financial policy. Sterling also received some help from strengthening oil prices following the intensification of the Gulf War, and reached \$1.1765 on 20 March. The $\frac{1}{2}$ percentage point cut in clearing banks' base rates to $13\frac{1}{2}$% announced the same day was widely anticipated and had little impact on sterling. Thereafter, as the dollar relapsed, sterling made sizable gains, to achieve a high of ERI 78.5 on 28 March. Some professional selling following the further base rate cut (to 13%) by National Westminster and Lloyds banks then caused sterling to settle back. It finished the month at ERI 77.2, \$1.23 and DM3.8007.

Although sterling was not affected by the announcement on 3 April that Barclays and Midland banks were cutting their base rates to $13\frac{1}{4}$%, it reacted adversely when BNOC announced on 4 April a \$1.15 per barrel cut in Brent crude oil prices and fell swiftly to ERI 76.3, \$1.1940 and DM3.7862 by the close that day, just before the Easter holiday. With news of the failure of another US securities firm on 8 April, however, the dollar eased again and sterling recovered in New York over the holiday. Good demand re-emerged after the release on 10 April of the provisional UK money figures for March showing a 1% rise in £M3; these figures were interpreted as ruling out any sizable reductions in interest rates in the near future. This coincided with an easier dollar. Sterling rose rapidly to touch \$1.2612 on 12 April before easing slightly following the announcement of a further $\frac{1}{2}$% cut in base rates by Barclays and Midland (to $12\frac{3}{4}$%). Thereafter UK interest rates were expected to remain firm and sterling continued to be the main beneficiary of the dollar's weakness, achieving a high of \$1.3025 in the Far East on the morning of 19 April. On the same day a further $\frac{1}{2}$% cut in base rates to $12\frac{1}{2}$% by National Westminster and Lloyds was absorbed without difficulty. Sterling's momentum was nevertheless insufficient to establish it above \$1.30 and, when the dollar rallied the following week, the pound fell back generally to touch a low of \$1.1955 on the morning of 26 April before recovering as the dollar's advance was temporarily checked. The announcement of the disappointing March trade figures later that day caused only momentary concern on the exchanges. Further buying helped take sterling to \$1.2515 on 30 April before rumours of a \$1 cut in the price of Soviet crude oil led to its being marked down to finish April at ERI 78.1, \$1.2385 and DM3.8418.

Sterling continued to ease against a strengthening dollar at the beginning of May, although it made good ground against Continental currencies, closing at ERI 77.6, \$1.2075 and DM3.8815 on the 3 May. Heavy selling developed in New York over the UK Bank Holiday on 6 May, in part reflecting renewed concerns that recent cuts in the price of Soviet crude oil would put further pressure on North Sea oil prices. Sterling's decline continued to \$1.1770 on 7 May before some strong demand re-emerged, as any hopes of an early reduction in domestic interest rates were quashed by a large rise (+2.9%) in April £M3. The recovery in sterling, which at times appeared to lead the dollar lower, peaked at the close on 14 May at ERI 79.2, \$1.2710 and DM 3.8778. Although sterling fell back, to \$1.2490 on 16 May, as the dollar firmed and on rumours of a cut in the Iranian oil price, it held up well against Continental currencies. Good demand soon re-emerged and sterling rapidly recovered lost ground to reach \$1.2935 in early trading on 20 May but, with the cross-rate above DM 3.90, sterling fell back to touch a low of \$1.2595 on 21 May. Its attempted recovery was interrupted in New York on 22 May, when sterling lost about $1\frac{1}{2}$ cents as perceptions re-emerged that it was over-valued at DM 3.90. On 24 May, widespread commercial selling also developed on a rumour that Saudi Arabia might be prepared to cut its oil price. Nevertheless, good demand eventually reappeared and sterling regained its general bouyancy, firming to finish the month at ERI 80.3 (up $12\frac{5}{8}$% over the period), \$1.2865 (+$18\frac{7}{8}$%) and DM 3.9328 (+$8\frac{5}{8}$%).

Official reserves

Over the three months to end-May, there was an underlying increase in UK reserves of \$736 million. Net public sector borrowing under the exchange cover scheme totalled \$243 million while \$217 million was repaid in respect of bonds issued in New York by HMG. The reserves rose by £37 million on account of the valuation adjustment arising from the quarterly roll-over of the

Changes in UK official reserves

$ millions

	1985				
	Jan.	Feb.	Mar.	Apr.	May
Change in reserves	**−173**	**−168**	**+ 286**	**+497**	**− 47**
of which:					
Net borrowing (+)/payment (−) of public debt	+127	+ 50	+ 27	+269	−270
Valuation change on roll-over of EMCF swap	− 18	—	—	+ 37	—
Underlying change in reserves	−282	−218	+ 259	+191	+223
Annual revaluation of reserves	—	—	−2,111	—	—
Level of reserves (end of period)	**15,521**	**15,353**	**13,528**(a)	**14,025**	**13,978**

(a) After the annual revaluation.

European Monetary Co-operation Fund swap. The effect of the annual revaluation of the reserves at end-March was to reduce their dollar value by $2,111 million, comprising a fall of $1,166 million on gold and a fall of $945 million on SDRs, ECUs and non-dollar currencies. At the end of May, the reserves stood at $13,978 million.

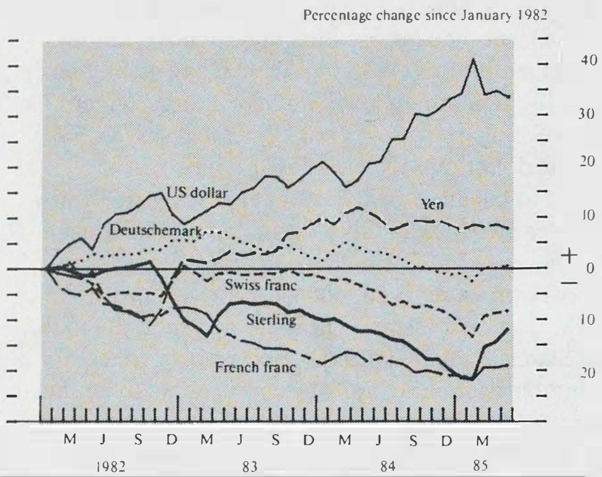
US dollar

The dollar opened on 1 March at DM3.3315, initially still subdued by central bank intervention. With this threat apparently removed after the weekend and with the Federal Reserve once again thought to be tightening monetary policy, the dollar recovered sharply. Despite bouts of nervousness on rumours of renewed official intervention, it moved back through the DM3.40 level to a high of DM3.4570 on 6 March before falling back in late business on reports of Federal Reserve Chairman Volcker's testimony to the House Budget Committee that the dollar could face a very sharp decline and that the US budget deficit was unsustainable; it touched a low of DM3.3737 in New York on 7 March. While the dollar received a brief boost on 7 March from a larger-than-expected increase in US money supply, its easier tone was confirmed by the signs of US economic slowdown detected in the February unemployment figures. With sentiment moving against it, the dollar fell back through DM3.40 to DM3.2850 on 12 March, at which point the market paused before taking it any lower. News of problems among Ohio thrift institutions and some more disappointing US economic indicators, led the dollar to resume its fall; it touched DM3.1925 on 20 March, before recovering to close at DM3.27. After the next day's 'flash' estimate for 1985 first quarter GNP (+2.1%), and particularly the price deflator (+5.4%), the dollar slid rapidly to a low of DM3.1875. Although it recovered in the following week, it weakened again from 26 March on concerns about the problems faced by some Texan banks, which it was felt might lead to a more accommodating Federal Reserve policy. The dollar touched DM3.0475 in the Far East on 29 March, before attempting a rally.

Helped by stronger indicators, which caused some revision to the market's expectations about US economic and monetary growth, the dollar moved back up to DM3.1775 in New York at the close on 4 April, but the recovery was interrupted by news on the evening of 8 April of the failure of another US securities firm. While this only briefly depressed the dollar (to a low of DM3.1165 on 9 April before it recovered to close at DM3.1652), subsequent rumours of difficulties among Oklahoma banks, fresh warnings from Chairman Volcker about fading economic growth and the announcement on 11 April of an unexpected fall in US retail sales (−1.9%) pushed the dollar rapidly back down. The dollar continued to fall after the release of an unexpectedly low first quarter preliminary GNP estimate (+1.3%) and a deflator figure (+5.3%) which was taken as confirming inflationary pressures, and touched a low of DM2.9515 in the Far East on 19 April. The market, especially in the United States, remained hesitant and ignored other unfavourable economic indicators. When the dollar failed to sustain a fall through the DM3 level, and with remarks by Chairman Volcker being interpreted as meaning the Federal Reserve would, if necessary, tighten policy to stifle inflationary pressures, the dollar reacted vigorously to reach a high of DM3.1612 on 26 April. Its momentum was insufficient, however, to establish it above DM3.16, and it dropped back to DM3.0720 at the opening on 30 April. Nevertheless, renewed expectations that the Treasury's latest financing package would stiffen US interest rates and expectations that March's employment figure would reveal renewed strength in the economy relaunched the dollar on an upward path, which carried it to a high of DM3.2625 in New York on 6 May.

The dollar lost its upward momentum at this level. Against the background of further official doubts cast on US economic growth prospects and with the Federal Reserve injecting reserves into the banking system while the Fed Funds rate was below 8%, rumours of central bank intervention sent the dollar rapidly back through the DM3.20 level to close at DM3.1795 on 7 May. Despite occasional brief rallies, a combination of a sustained bond market recovery in the United Kingdom, the re-emergence of concerns about US thrifts and optimism about some easing in US monetary policy took the dollar to a low of DM3.0510 at the close on 14 May. Although the dollar eventually managed to recover and was able to absorb a $\frac{1}{2}$% cut in US prime rate on 15 May, to reach DM3.1172 on the morning of 17 May, it fell again following the $\frac{1}{2}$% cut in the US discount rate (to $7\frac{1}{2}$%) on the same day to a low of DM3.0190 on 20 May. With the discount rate adjustment seen as a response to weakening US industrial performance, market forecasts of the first quarter GNP figure were revised down although when the actual figure of 0.7% was published the dollar soon recovered to reach DM3.0935 in Frankfurt on 21 May. The market was reluctant to adopt aggressive positions without some clearer indication of the dollar's trend and the dollar failed to sustain itself above the DM3.10 level, falling back to DM3.0660 in New York on 23 May, before gradually recovering to close on 24 May in Frankfurt at DM3.0930. The dollar continued to drift upwards in the thin conditions, despite a very sharp rally in the US Treasury bond market, to reach DM3.1120 at the close on 28 May before falling sharply following the release of poor first quarter productivity figures, to close on 29 May

Indices of effective exchange rates



at DM3.0875. The dollar finished the period down $8\frac{5}{8}$% at DM3.0570 and, in effective terms, down $5\frac{3}{8}$% at 145.3.

EMS

Although the narrow band of the EMS came close to reaching its maximum width in late January and early February, the EMS remained stable and almost free of tension throughout the current period. The width of the narrow band was unchanged over the period at 2%. The Belgian franc replaced the Dutch guilder at the bottom of the system for virtually all of the period from 18 March and the Irish pound replaced the Danish krone at the top from 15 April. The Italian lira, which is allowed a 6% divergence from other EMS currencies, moved from a premium to a discount against its ECU central rate in March.

Other currencies

The yen recovered against the dollar during the first half of the period but thereafter tended to be steadier against the dollar than were the other major currencies. Over the period, the yen appreciated by $3\frac{1}{8}$% to ¥251.48 but fell by $\frac{7}{8}$% in effective terms to 154.1.

The Swiss franc appreciated sharply over the first half of the period before easing back sharply in late April and then fluctuating erratically in May. Over the three months, it appreciated by $9\frac{7}{8}$% to Sw. Fcs 2.5725 and by $5\frac{7}{8}$% in effective terms to 139.8.

Gold

The gold market recovered sharply in the middle of March following news of problems in Ohio thrift institutions and on the weaker dollar, with the price moving back up above \$300 and at one point touching \$350 in very volatile trading conditions. Although news of further problems in the US financial sector helped support the price, it gradually eased back and then fell particularly sharply at the beginning of May. After a brief rally in the middle of May, the price fell back again to finish the month at \$314.

London gold price