International financial developments

Among the main recent developments:

- *The combined current account deficit of the major seven OECD countries was unchanged in the second quarter, with a further increase in the US deficit being offset by improvements in Japan and in Europe.*

- *The improvement in the current account position of developing countries in 1984 was less than had earlier been thought, and the deficit widened again in the first six months of 1985: with net capital inflows in the first quarter also markedly lower, developing countries' reserves fell.*

- *Floating-rate note issues were again buoyant and the range of currencies in which they are available has broadened: innovation and evolution of the interest rate structure of FRNs has been a particular feature of recent months.*

- *Strong growth in note-issuance facilities continued in the second quarter and facilities are increasingly offering a range of alternative borrowing options.*

- *In the foreign exchange markets, the dollar weakened further. Sterling continued to firm in July but subsequently experienced wide fluctuations. The EMS was realigned in July, with the Italian lira effectively devalued by $7\frac{7}{8}$% within the system.*

World current account positions

The combined current account deficit of the *major seven economies* was unchanged in the second quarter of 1985, following a sharp deterioration in the previous three months. The US current account deficit widened again, while the Japanese surplus recovered to the level of the final quarter of 1984. In Europe, there was some evidence in the second quarter of a recovery from the effects of the severe winter and the adverse movements in the terms of trade, and the current accounts of France and Germany both improved. The Italian deficit, however, continued to deteriorate.

The combined current account of the *other OECD economies* continued to improve during the first quarter of 1985. Continued tight financial policies and structural adjustment measures resulted in widespread improvements, leaving the overall current account broadly in balance. In contrast to the general trend, the Swedish current account deteriorated sharply in the first quarter and the increase in imports was sufficient to prompt emergency measures by the Swedish government in May.

The *oil exporting countries'* aggregate current account improved markedly in 1984, as a slight drop in oil revenues was more than offset by continuing import restraint. Subsequently, however, lower oil production, combined with cuts in OPEC official prices, has brought a return to deficit.

World current accounts(a)
$ billions: *seasonally adjusted*

	1983	1984			1985	
	Year	Year(b)	Q3	Q4	Q1(b)	Q2(b)
OECD economies:						
Canada	1	2	1	1	1	—
France	− 5	—	1	—	− 1	1
Germany	5	7	2	4	2	3
Italy	1	− 3	—	− 1	− 3	− 5
Japan	21	35	7	12	10	12
United Kingdom	5	1	− 1	—	—	2
United States	−41	−102	−33	−26	−30	−35
Major economies	−14	− 61	−23	− 9	−21	−21
Other OECD	− 9	− 3	− 2	− 2	—	..
Total OECD	−23	− 64	−25	−11	−21	..
Oil exporting economies	−13	5	2	1	− 1	..
Other developing economies	−37	− 26	− 6	− 6	− 8	..
Other economies(c)	7	9	2	3	3	..
World discrepancy(d)	−66	− 76	−28	−13	−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.

The current account deficit of the *non-oil developing countries* now appears to have improved less in 1984 than was suggested in the June *Bulletin*. Continued growth of import volumes and relative weakness of both oil and non-oil exports contributed to a poorer than expected outturn for the second half of the year. During the first quarter of 1985, both export and import prices were weak, with imports and exports falling when measured in US dollars, and the current account deficit is estimated to

Prospects for non-oil developing countries

A survey has recently been undertaken in the Bank of prospects for twenty non-oil developing countries,[1] which together account for over half the trade of all such countries and some three quarters of their international debt.

Developing countries in the base forecast

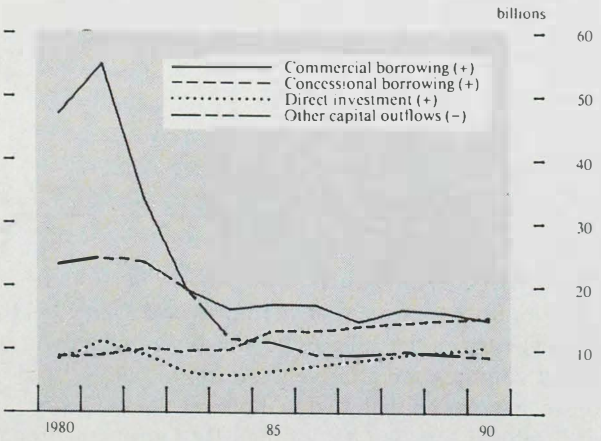
	1984	1985	1986–90 (average)
		Percentage change	
Export markets	10.4	5.7	4.8
Non-oil export volume	15.9	7.3	6.2
Non-oil import volume	12.5	9.3	6.7
Terms of trade (change)	1.3	– 0.7	0.2
			$ billions
Trade balance	13.5	10.6	19.3
Current account	–16.5	–23.8	–24.9
Selected capital flows:			
Commercial borrowing	16.4	17.2	15.7
Concessional borrowing	10.1	13.1	14.2
Direct investment	5.9	6.6	9.0
Other capital flows	–11.7	–11.1	– 9.2
Reserve change (increase –)	–10.0	– 2.3	– 4.4

In the base forecast, the major industrial economies grow on average at 3% per annum from 1985 to 1990, world trade expands by some 5% per annum, world interest rates decline somewhat and the dollar depreciates; the oil market is assumed to remain weak. Although world inflation remains low, prices expressed in dollars rise faster than in recent years, reflecting dollar depreciation. Measured against world prices, real interest rates on dollar-denominated debt decline markedly compared with the recent past.

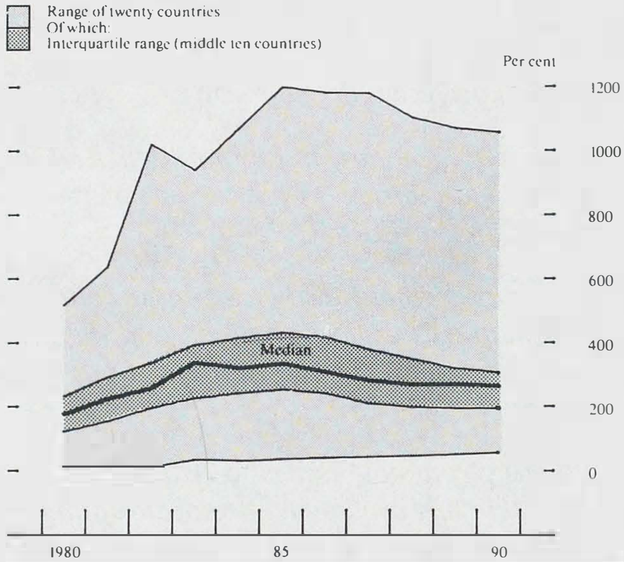
For nearly all the countries considered, the availability of external finance is a major factor in their prospects. For most, access to commercial borrowing is expected to be extremely restricted, and others are expected to be cautious in their borrowing. Commercial borrowing as a whole is not expected to exceed the levels of the last two years, with other net capital inflows rising only slowly. Although less of these inflows may be added to reserves than last year, these countries are not expected to be able to finance current account deficits of more than about $25 billion per annum (half the rate of the early 1980s). With continuing deficits on invisibles (including interest payments), the combined trade balance is forecast to remain in surplus through to the end of the decade.

Non-oil exports are expected to continue to grow rather faster than markets. With only small changes in the terms of trade, and given available finance, this might allow non-oil import growth of an average 7% per annum. In many of the countries surveyed, output and demand have risen more slowly than population in recent years, with investment expenditure in particular cut back. Although in aggregate output and demand should now grow faster (perhaps 4½% and 5½% per annum respectively), for more than half the sample, output and demand per head may fall between 1980 and 1990.

Twenty developing countries: selected capital flows



Debt/export ratios



Gross external debt may grow little in real terms, or not at all. Individual debt ratios vary widely, but in most cases are forecast to decline, although not to the levels seen at the beginning of the decade.

The outlook is very sensitive to the world environment. The table below shows, for the sample as a whole, the effects of varying some of the assumptions made in the base forecast. (Different assumptions about the international value of the dollar, and hence real interest rates on dollar-denominated debt, would also have a marked effect.) The effects on individual countries are even more significant. For example, the adverse effects of a lower oil price would be concentrated on the small number of oil exporters in the sample; the beneficial effects, though greater in total, would be more thinly spread. And if lower world trade came about through greater protectionism, some countries would be particularly hard hit, depending on the composition of their trade.

The survey as a whole suggests that although prospects for the developing countries as a whole are moderately encouraging, this is not necessarily true of all individual countries. And the outlook is subject to significant risks.

Effect of variation in selected assumptions

Figures show deviations from base forecast in 1990

	Export revenue $ billions	Import cost $ billions	Current account $ billions	Debt/Export ratio % points
Decrease of $1 per barrel in oil price	–1.4	–1.8	+1.1	–0.7
Decrease of 1% point in world trade	–8.2	–4.5	–4.0	+7.7
Increase of 1% point in Libor	+0.4(a)	+3.9(b)	–1.2	+1.8

(a) Interest receipts. (b) Interest payments.

(1) The countries are Argentina, Brazil, Chile, Colombia, Egypt, India, Ivory Coast, Jamaica, Kenya, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Singapore, Sudan, Thailand, Zambia and Zimbabwe.

Developing countries' balance of payments

$ billions: *not seasonally adjusted*

	1983	1984(a)					1985(a)
	Year	Year	Q1	Q2	Q3	Q4	Q1
Current account	**−37**	**−26**	**−6**	**− 7**	**−8**	**− 6**	**−8**
Capital account	**31**	**36**	**7**	**10**	**9**	**10**	**3**
of which:							
Concessionary and other official flows	24	25	6	6	6	6	6
Direct investment	8	7	1	2	2	2	1
Borrowing from banks(b)	12	10	2	3	2	4	−2
Borrowing via bond issues	2	3	1	—	1	1	1
Other capital flows(c)	−15	−10	−3	− 1	−2	− 4	−4
Official financing balance	**6**	**− 9**	**−1**	**− 3**	**−2**	**− 4**	**6**
of which:							
Use of IMF credit	10	4	1	2	1	1	—
Liabilities to other CMIs	1	1	—	—	—	—	—
Reserves etc (increase−)	− 5	−15	−2	− 5	−2	− 5	5

(a) Includes Bank estimates/forecasts.

(b) Adjusted to exclude valuation effects.

(c) Includes net errors and omissions.

have increased marginally. First indications for the second quarter show that, while import prices recovered somewhat and import volumes continued to grow, the recovery of exports was weaker, leading to a more marked deterioration in the current account deficit.

Capital movements

Capital inflows to the *non-oil developing countries* in the first quarter of 1985 were not sufficient to cover the current account deficit and reserves fell by $5 billion. Following an increase in the final quarter of 1984, borrowing from banks in the BIS reporting area fell during the first quarter, the first such fall for over two years. Revised figures for direct investment during 1984 show a slight fall compared to 1983, whereas previously a small increase was estimated to have taken place. Direct investment remained weak in the first quarter of this year, showing little increase compared to the same period of 1984. South East Asian countries remained prominent among non-oil developing countries raising money via portfolio investment in the second quarter, with Korea, Malaysia, Singapore and Thailand accounting for most of the finance raised through bonds and similar instruments.

The current balance and net funds available for deployment of *oil exporting countries* remained low in 1984, as they had done in the two previous years. These countries continued to diversify their portfolios during 1984 with the level of placements falling in the United States, the United Kingdom and other European Community countries but rising in the other industrial countries and offshore centres (in the latter case because of valuation changes rather than net new inflows). In the first quarter of 1985, there was an overall rise of $3 billion in eurocurrency deposits, partly offset by a fall of $1.2 billion in domestic currency bank deposits. Other investments in the industrial countries were also reduced (by $2.3 billion). Provisional indications suggest that, in the second quarter, deployment in the United Kingdom increased by $2.8 billion, mostly in the form of eurocurrency deposits. In contrast, both bank deposits and other investments in the United States were reduced.

Capital movements among the major economies have been dominated by the flows into the United States and out of Japan which are counterparts of their large current account imbalances. In the fourth quarter of 1984, net sales overseas of US securities totalled over $18 billion (of which Treasury securities accounted for more than half) while a small net outflow took place through the banking system in the second half of the year. Provisional data for the first quarter of 1985 suggest that net overseas sales of US Treasury securities fell back to $2½ billion, although sales of other securities remained at the high level of the previous quarter; strong inflows through the banks resumed. Some counterpart to these security

Identified deployment of oil exporters' funds(a)

$ billions

	Dec. 1983 levels	1984			Dec. 1984 levels	1985	
		H1	Q3	Q4		Q1	Q2(b)
Industrial countries							
United Kingdom:							
Sterling bank deposits	4.9	0.6	0.2	0.1	4.7	−0.1	0.1
Eurocurrency bank deposits	43.9	0.2	0.8	−3.0	41.2	—	2.3
Government paper	3.4	−0.4	0.1	−0.2	2.2	−0.1	0.3
Other investments	5.6	−0.3	−0.2	—	5.0	−0.1	0.1
	57.8	0.1	0.9	−3.1	53.1	−0.3	2.8
Other EEC:(c)							
Domestic currency bank deposits	4.2	−0.1	—	−0.1	3.5	−0.3	
Eurocurrency bank deposits	20.6	−1.3	1.2	0.6	20.4	1.1	
Other investments	32.1	−0.3	−0.2	−0.1	28.3	−0.3(b)	
	56.9	−1.7	1.0	0.4	52.2	0.5	
United States:							
Bank deposits	17.7	1.4	0.5	1.6	21.2	−0.2	−0.8
Government paper	34.7	−3.1	−0.9	0.5	31.2	0.2	0.1
Other investments	33.7	−0.4	−2.1	−0.1	31.1	−0.5	−1.0
	86.1	−2.1	−2.5	2.0	83.5	−0.5	−1.7
Other:							
Domestic currency bank deposits	3.3	0.5	0.3	−0.4	3.4	−0.6	
Eurocurrency bank deposits	26.9	−0.2	0.5	0.3	27.3	0.9	
Other investments	38.7	0.7	1.3	1.0	40.0	−1.5(b)	
	68.9	1.0	2.1	0.9	70.7	−1.2	
Offshore centres:							
Bank deposits	36.6	−1.8	−0.1	0.6	42.4	1.0	
Placements with ldcs	58.0	1.1	−0.2	0.4	59.3	—	
OEC credit to non-banks	7.7	0.4	0.5	—	8.5	..	
IMF and IBRD(d)	36.1	1.1	−0.5	−1.1	32.3	0.4	0.1
Total identified additions(+)/reductions (−) in deployed assets	**408.1**	**−1.9**	**1.2**	**0.1**	**402.0**	**−0.1**	..
Net funds available for deployment		5.9	−0.4	0.7		−1.5	
of which:							
Net movements in external borrowing etc		*0.6*	*−0.5*	*1.2*		*−0.5*	
Current balance		*5.3*	*0.1*	*−0.5*		*−1.0*	

.. not available.

(a) The notes and definitions to Table 16 in the statistical annex of the March *Bulletin* give a list of oil exporting countries.

(b) Provisional.

(c) Includes Spain and Portugal.

(d) Includes holdings of gold.

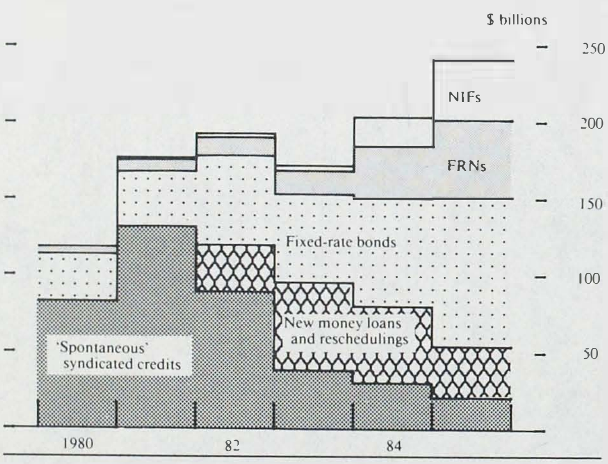
sales may be found in the Japanese capital account. Transactions in foreign bonds accelerated rapidly during 1984 and 1985, resulting in net acquisitions of foreign securities of over $20 billion in the second half of last year and nearly $25 billion in the first six months of 1985. Net foreign acquisitions of Japanese securities totalled about $11 billion in this period.

International capital markets

The changes which have been taking place in the last few years in the relative importance of the different sectors of the international capital markets, all part of the shift towards lending in a marketable form, have been further accentuated in the first eight months of 1985. Overall, activity was 20% up (at an annual rate) on 1984, itself a record year when over $200 billion was raised in the markets. In 1984, 60% of the total raised came from the securities sectors and 40% in the form of syndicated lending, and rescheduling and new money commitments; in 1985, with strong growth in fixed-rate eurobonds, FRNs and note issuance facilities, the securities sectors have contributed almost 80%, even when reschedulings and new money loans are included in the category of syndicated bank lending. Innovation has continued apace, most notably in the note issuance facility sector, where non-underwritten facilities and complex facilities with extra borrowing options have become common.

International capital market activity

1985 first eight months at annualised rate



After a period when it seemed that spreads on syndicated credits had stabilised, for most borrowers at historically very low levels, many borrowers, especially those from the Eastern bloc, have benefited from a further improvement in terms and conditions. A number of borrowers have refinanced borrowings more cheaply, including Sweden, France and the EEC, each with refinancings of over $1 billion.

Fixed-rate bonds

After some months in which the volume of fixed-rate eurobond issues was in the range $6–8 billion, issues rose to a peak of $11.2 billion in July, before falling to $7.6 billion in August. Expectations of rising dollar bond prices seemed for a time to offset investors' concerns about the weakness of the dollar exchange rate; the share of new issues denominated in US dollars, after falling below 30% in April, was consistently over 50% for the following three months. New issues during August, however, showed a trend away from the dollar, and a proliferation of dual currency (especially yen/dollar) issues. The yen's share of new issues fell from almost 20% in April to below 5% in July, as issuing activity switched to some minor currencies: in July and August, over 10% of new fixed-rate issues were denominated in Australian or New Zealand dollars. Among the attractions of these currencies for borrowers were the currency swap opportunities available, while for investors they offered relatively high nominal interest rates and the possibility of appreciation against the US dollar. Similar considerations appeared to explain the popularity of the ECU, which accounted for 9% of issues in the second quarter and 7% in July and August.

Issues for US borrowers fell by $2.4 billion to $5.4 billion in the second quarter, 25% of total issues, compared with 33% in the first quarter. Japanese borrowers were also less active in the second quarter, raising $3.8 billion, but this was followed by $3.2 billion in July and August. Following the repeal, with effect from 1 April, of the withholding tax payable by Japanese companies on euroyen issues sold to foreign residents, Japanese companies issued ¥80 billion ($320 million) of yen eurobonds in the second quarter—all convertible issues—but none in July or August. French borrowers raised $1 billion in July after raising only $700 million in the whole of the second quarter.

Floating-rate notes

FRN issues recovered strongly in the second quarter, raising $13.4 billion, followed by $8 billion in July, but fell back sharply to $2.2 billion in August. The range of currencies in which FRNs may be issued has been broadened: deutschemark FRNs were permitted from the beginning of May and euroyen FRNs from the beginning of June. The progress of these two markets after liberalisation differed, however. Issues of DM FRNs declined after an initial burst of activity and no further issues are planned for September, while euroyen FRNs had a slow start, and the first issue was not made until mid-July. During the second quarter, FRNs were also

Completed international bond issues[(a)]

$ billions: *percentages in italics*

	1984			1985			
	Q2	Q3	Q4	Q1	Q2	July	Aug.
Fixed-coupon bonds							
Borrower:							
Major OECD countries	7.9	10.1	14.6	17.5	12.9	7.6	4.2
of which:							
United States	1.9	3.8	8.0	8.1	5.4	2.7	1.3
Japan	3.3	3.5	2.9	5.6	3.8	2.0	1.2
Minor OECD countries	3.0	2.9	4.1	3.3	4.5	1.8	1.5
International institutions	2.2	3.0	4.2	3.4	2.8	1.6	1.7
Other	0.5	0.5	0.6	0.5	1.0	2.0	0.2
Total	**13.6**	**16.5**	**23.5**	**24.7**	**21.2**	**11.2**	**7.6**
Currency:							
US dollars	*36.2*	*52.6*	*56.3*	*55.3*	*45.3*	*51.3*	*41.5*
Swiss francs	*27.2*	*17.0*	*9.8*	*12.6*	*12.0*	*9.8*	*11.1*
Yen	*11.2*	*7.6*	*10.0*	*9.7*	*10.8*	*4.8*	*11.8*
Other	*25.4*	*22.8*	*23.9*	*22.4*	*31.9*	*34.1*	*35.6*
Floating-rate notes							
Borrower:							
Major OECD	3.1	5.7	7.2	7.0	7.9	5.2	1.4
Minor OECD	2.6	2.0	2.8	1.5	3.4	0.8	0.4
Other	0.2	0.4	1.4	1.5	2.1	2.0	0.4
Total	**6.0**	**8.1**	**11.4**	**10.0**	**13.4**	**8.0**	**2.2**

(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.

issued in sterling, ECU and Swiss francs, with the result that, unusually, less than 90% of issues were denominated in dollars.

The interest rate structure of FRNs has been evolving. Up to 1983, the great majority of FRNs bore a coupon of a margin over 6-month Libor (London interbank offered rate). Since then, a growing proportion have carried a coupon based on Libid (London interbank bid rate, generally about $\frac{1}{8}$% below Libor) or the mean of the bid and offered rates. Less than 40% of the FRNs during the second quarter of 1985 carried a coupon based on the conventional non-mismatched 6-month Libor, compared with over 90% in 1983. Mismatch FRNs were introduced in 1984 to allow investors to take advantage of a steeply upward-sloping yield curve by, for example, funding themselves at the 1-month rate but receiving the higher 6-month rate, reset monthly. Almost 30% of the funds raised by FRNs in the second quarter of 1985 took the form of mismatch FRNs, mostly arranged during March when the yield curve was particularly steep. The most recent development has been capped FRNs, which raised $2.9 billion during July. They carry a coupon based on a floating-rate index but with a maximum interest rate, typically around 13%, and a coupon of around Libid +$\frac{3}{8}$% —a higher spread than usual for the borrowers involved, but offset by the advantage of the cap.

Banks have been the main issuers of FRNs recently. During June and July, British banks raised $3.8 billion in the form of primary capital FRNs. These issues are perpetual and subordinated and contain a provision that in the event of liquidation the holders would receive payment as if they were holders of preference shares, thereby meeting the essential objectives of the Bank of England's requirements for primary capital (notably the ability to absorb losses). French banks raised $1.8 billion in July and August. In addition, the EEC raised $1.8 billion, to be used to prepay a $1.8 billion issue raised by the EEC on behalf of France in 1983.

Note issuance facilities

The strong growth in the arrangement of note issuance facilities continued in the second quarter with $14.0 billion of facilities announced, over $5 billion up on the first quarter. Announcements fell back somewhat in July and August to $3.9 billion. Non-bank corporations have become by far the most active type of borrower. In the second quarter there were $6 billion of facilities for corporate borrowers from the United States, including two facilities of over $1 billion. UK companies arranged facilities of more than $1 billion in July and August. Borrowers from Australia, France, and Sweden were also active; Swedish borrowings included a complex $1.8 billion facility under which drawings may be made in a number of different forms.

Around half of the facilities arranged in the second quarter included borrowing options additional to the issue of euronotes. The most common of these options are short-term multicurrency advances, which give borrowers a wider choice of currencies than is available with notes, and are also preferred by some banks as an alternative to holding notes; swinglines, which enable borrowers to make drawings at short notice to cover the delay in issuing notes or making other forms of drawing; bankers' acceptances (generally in US dollars or sterling); and sterling 1–5 year notes. A number of facilities also provide for the transferability of underwriting commitments.

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	2.34	0.92	**8.05**	*5.61*	*1.34*	*1.10*(c)
1985 Q1	5.21	3.10	0.39	**8.70**	*5.81*	*2.39*	*0.50*
Q2	9.24	3.62	1.17	**14.03**	*9.09*	*2.24*	*2.70*(c)
1985 July	1.22	0.60	0.17	**1.99**	*1.83*	*0.16*	—
Aug.	0.87	0.99	0.05	**1.91**	*1.71*	*0.20*	—

(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.

A further development has been the increasing number of non-underwritten or only part underwritten facilities (which may, in some cases, be backed by a general line of credit to the borrower). Nearly 30% of the facilities announced in the second quarter and in July and August were not fully underwritten, compared with 20% in the first quarter and only 10% in the fourth quarter of 1984. A number of non-underwritten euro commercial paper programmes were also arranged.

A few facilities were structured in two parts, so that the underwriting back-up appears to be quite separate from the note issuance part. This was interpreted in some quarters as a way of attempting to circumvent the Bank of England's recent guidelines on NIFs and RUFs— although the resultant facility is much the same as a normal underwritten facility. The Bank, which recognised that the market would produce variants, is presently reviewing the whole range of off balance sheet risks (including standby and other commitments) to which banks may be exposed, in order to assess these risks more accurately in its prudential supervision.

Syndicated lending

Announcements of syndicated credits in the second quarter were only $5.6 billion, the same low level as in the first quarter. There was no sign of a pick-up in July and August. Banks' commitments under rescheduling and new money packages, at $9.1 billion, were $1.4 billion higher than the previous quarter, the increase reflecting

'Spontaneous' medium-term credits

$ billions

	Total	Major OECD	Minor OECD	Non-OECD	*of which:* Oil exporting countries	*of which:* Developing countries	*of which:* 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 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	**5.69**	1.70	1.66	2.28	*0.37*	*1.20*	*0.64*
Q2	**5.58**	0.85	1.39	3.34	*0.19*	*1.35*	*1.74*
July	**1.14**	0.25	0.38	0.51	—	*0.30*	*0.20*
Aug.	**1.48**	0.34	0.31	0.83	*0.01*	*0.65*	*0.16*

(a) Quarterly average.

the announcement for Chile of a $6 billion rescheduling and a $1.1 billion new money loan.

After the recent growth of transferable loans, only a small number of new loans in the second quarter were in a transferable form. Eastern bloc countries were the largest borrowers in the credits market in the second quarter, raising $1.7 billion (and a further $350 million in July and August); borrowers included two countries (Bulgaria and Czechoslovakia) returning to the market after long absences. Hungary saw a marked improvement in its standing, raising a World Bank co-financing loan and a further market loan, and the USSR borrowed on terms comparable with the very top borrowers. There was little new borrowing by OECD countries with the exception of Italy, whose borrowers continue to favour credits rather than NIFs. However, OECD borrowers renegotiated terms on $7.1 billion of existing borrowings in the second quarter and refinanced $5.5 billion. Borrowing by developing countries was again mostly by South Korea. Colombia arranged a $1 billion financing (not included in the figures) for two export-related projects.

International banking developments

This section assesses the international business of banks in the BIS reporting area and, separately, of banks in the United Kingdom. It draws on two sets of BIS data, covering the maturity of banks' consolidated external lending in the second half of 1984 and developments in international business in the first quarter of 1985, together with statistics for UK banks in the second quarter of 1985. Around one quarter of total international lending by banks is booked in the United Kingdom and London market developments are an important early indicator of wider movements in banking flows.

Banks in the BIS reporting area (first quarter of 1985)
The pick-up in external lending by BIS-area banks in the final quarter of 1984 continued in the first quarter of 1985. However, the strength of lending in both quarters was concentrated in the interbank market within the reporting area. In the first quarter of 1985, lending to outside-area countries fell for the first time since the BIS began collecting international banking data. At the same time, estimated international lending to final users, a measure which includes external lending and foreign currency claims on residents, fell back to the lowest pace for two years. The statistics understate total lending because they do not fully capture banks' purchases of securities, issues of which continued apace in the first quarter, and lending to the outside area is usually restrained early in the year. But allowance for these factors does not alter the picture of very modest growth in lending to final users by the standards of recent years.

The usual financial year end balance sheet expansion of Japanese banks was apparent in the interbank lending figures, but the main reason for the rapid rate of lending was the absence of the expected seasonal contraction in the interbank business of continental banks. There was also unusually strong growth in business between the offshore centres and banks in other reporting centres.

The share of US dollar denominated lending fell again in the first quarter of 1985, accounting for only 15% of external lending for which a currency breakdown is available, although at end-March 1985 over 70% of outstanding external assets were still denominated in dollars. Sterling was the single most important currency for new external lending in the first quarter, followed closely by the Swiss franc: eurosterling lending grew at a record pace and the external sterling claims of banks in the UK also rose rapidly. ECU lending, too, grew at an unprecedented rate and yen-denominated lending was again popular.

The external deposits of banks in the BIS area also rose rapidly in the first quarter, with the rise specific to inside-area interbank business. The deposits of outside-area countries fell for the first time since the second quarter of 1983. Within this total, the deposits of the non-oil developing countries, and in particular those in Latin America, fell for the first time since the third quarter of 1982. Deposits from Eastern Europe fell sharply.

External business of banks in the BIS reporting area

$ billions: changes exclude estimated exchange rate effects

	1984 Year	1984 Q3	1984 Q4	1985 Q1	Outstanding at end-March 1985
Deposits from					
Outside reporting area:					
Developed countries	+ 5	+1	+ 2	—	29
Eastern Europe	+ 4	+1	+ 1	− 3	19
Oil exporting countries	+ 3	+3	—	+ 1	149
Non-oil developing countries	+ 22	+2	+ 7	− 2	168
of which, Latin America	*+ 11*	*+3*	*+ 3*	—	*68*
Sub-total	+ 35	+8	+11	− 4	365
Inside reporting area	+116	−7	+45	+65	1,780
Unallocated	− 1	+3	− 6	− 1	53
Total	**+149**	**+4**	**+51**	**+60**	**2,198**
Lending to					
Outside reporting area:					
Developed countries	+ 8	+2	+ 1	+ 1	89
Eastern Europe	+ 1	—	+ 1	− 1	48
Oil exporting countries	—	−2	+ 2	− 1	106
Non-oil developing countries	+ 9	+1	+ 4	− 2	330
of which, Latin America	*+ 4*	—	—	*− 1*	*212*
Sub-total	+ 16	+1	+ 8	− 2	573
Inside reporting area	+112	−5	+47	+54	1,606
Unallocated	− 1	−1	+ 1	+ 1	43
Total	**+126**	**−5**	**+55**	**+53**	**2,222**

The BIS semi-annual statistics providing a maturity analysis of lending to outside-area countries moved from a partly consolidated to a fully consolidated basis at end-December 1984.[1] This change makes interpretation difficult. There was a modest reduction in the proportion of short-term claims in the second half of 1984, particularly in the case of lending to Asia and Latin America, but much of the fall may be explained by the further consolidation, in which predominantly short-term inter-office positions are netted out. More significantly, undisbursed commitments fell from the equivalent of 17.5% of total claims at end-June 1984 to 15.3% at end-December, despite the extended coverage of the data.

The London market (second quarter of 1985)
The rate of growth of international lending by banks in the United Kingdom slackened in the second quarter of 1985 after relatively strong growth in the first quarter. The components of international lending did not move in unison. Foreign currency lending to UK residents fell in absolute terms, as did the external lending in sterling and foreign currency which can be allocated geographically (shown in the accompanying table). In contrast, external lending in the form of purchases of investments, principally floating-rate notes (which cannot be allocated geographically and is not shown in the table), again rose strongly. The seasonal contraction in the business of Japanese banks in London partly explains the overall slowdown in the growth of international lending but the activity of most other bank nationality groups was restrained.

However, the reduction in external lending was confined to the interbank market within the BIS area. Lending to countries outside the BIS reporting area and the offshore banking centres rose more rapidly than for well over a year, after falling in the first quarter in line with developments in the lending of all banks in the BIS area. The major rise was in lending to Eastern European countries whose return to the international capital markets has been visible for some time but which has not until now been reflected in the banking statistics. The increase of over $1 billion in lending to Eastern bloc borrowers more than offset the cumulative reduction in lending to the area by UK banks in the past two years.

The external deposits of banks in the United Kingdom rose much less rapidly than in the first quarter, but the slowdown was entirely attributable to the greatly reduced pace of interbank deposits from other BIS-area countries. Having fallen in the first quarter, the deposits of countries outside the reporting area rose again, with higher liabilities to the oil exporting countries responsible for two thirds of the total rise. In contrast to the overall position, deposits from Latin America fell for the second consecutive quarter and at a faster rate than in the first quarter of the year.

External business of banks in the United Kingdom

$ billions: changes exclude estimated exchange rate effects

	1984				1985	
	Year	Q2	Q3	Q4	Q1	Q2
Deposits from:						
BIS reporting area(a)	+25.3	+11.0	−0.6	+5.6	+12.7	+0.2
Offshore banking centres(b)	+ 7.4	− 0.3	+0.1	+1.3	+ 3.4	−1.6
Sub-total	+32.7	+10.7	−0.5	+6.9	+16.1	−1.4
Developed countries	+ 1.6	+ 0.5	+0.6	+0.4	+ 0.3	+0.5
Eastern Europe	+ 0.9	− 0.1	−0.6	+1.2	− 0.8	+0.7
Oil exporting countries	− 1.1	+ 0.9	+1.0	−2.9	−0.1	+2.4
Non-oil developing countries	+ 4.7	+ 2.7	−1.9	+1.4	− 0.6	+0.1
of which, Latin America	*+ 2.8*	*+ 1.8*	*+0.3*	*+0.4*	*− 0.2*	*−0.7*
Sub-total	+ 6.1	+ 4.0	−0.9	+0.1	− 1.2	+3.7
Others	− 2.6	− 2.2	−0.8	+0.4	− 0.2	+1.1
Total	**+36.2**	**+12.5**	**−2.4**	**+7.4**	**+14.7**	**+3.4**
Lending to:						
BIS reporting area(a)	+15.2	+ 0.1	−3.4	+4.1	+ 8.7	−4.2
Offshore banking centres(b)	+ 9.3	+ 8.9	+1.3	−1.0	+ 0.2	+0.8
Sub-total	+24.5	+ 9.0	−2.1	+3.1	+ 8.9	−3.4
Developed countries	+ 1.2	+ 0.4	+0.2	+0.4	+ 0.6	+0.3
Eastern Europe	− 0.4	− 0.2	—	−0.1	− 0.1	+1.1
Oil exporting countries	− 1.0	+ 0.7	−0.9	−0.7	+ 0.1	−0.3
Non-oil developing countries	+ 1.1	+ 1.0	−0.4	−0.2	− 0.7	+0.9
of which, Latin America	*+ 1.9*	*+ 0.7*	*+0.1*	*+0.4*	*− 0.3*	*+0.2*
Sub-total	+ 0.8	+ 1.9	−1.1	−0.6	− 0.1	+2.0
Others	—	+ 0.6	−0.6	+0.1	+ 0.2	+0.5
Total	**+25.3**	**+11.5**	**−3.8**	**+2.6**	**+ 8.8**	**−0.9**

(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-August.
The dollar moved lower as doubts grew about the continued strength of US economic growth and expectations were raised that the Federal Reserve would consequently adopt a more accommodating policy stance. Sterling was at first the main beneficiary of the dollar's weakness, reflecting the relatively high level of UK interest rates, but then fell back on expectations of further interest rate cuts and on oil price considerations. A realignment of the European Monetary System (EMS) was effected on 22 July, in which the Italian lira was devalued by $7\frac{7}{8}$% in terms of its bilateral central rates against the other currencies participating in the exchange rate mechanism of the EMS. Subsequently, however, outflows from the dollar into the deutschemark and the Dutch guilder generated new strains within the EMS.

Sterling

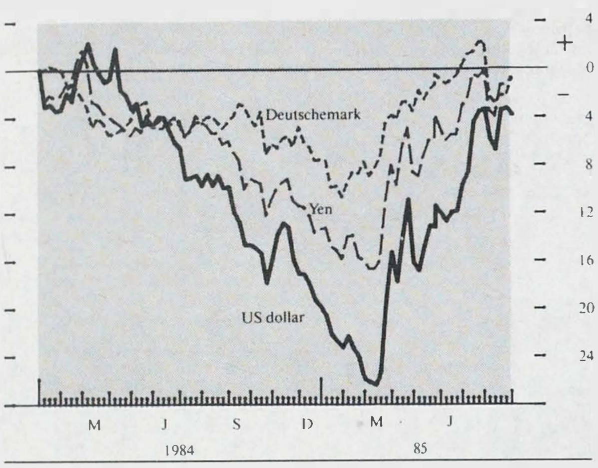
The principal influence on sterling continued to be the relatively high level of UK interest rates. The pound therefore once again became the main beneficiary of the dollar's decline, at times experiencing some very heavy demand. The pound was able to absorb, with little immediate difficulty, cuts in clearing banks' base rates totalling 1%–$1\frac{1}{4}$% but came under selling pressure at the end of July and in early August on fears that the authorities would seek to continue the pace of interest rate reductions. These fears also exposed sterling to oil price uncertainties, which had not been the case earlier in the period.

The pound opened the period on 3 June at ERI 80.7, $1.2985 and DM 3.9371 in London. On good demand, it had been able to overcome earlier concern about the oil

(1) The notes and definitions to Table 13.2 in the March 1985 *Bulletin* describe the nature of the consolidated data available at end-December 1983. The five countries which did not supply consolidated statistics to the BIS at that date began to do so for end-December 1984.

Sterling against selected foreign currencies

Change from
end-Dec. 1983



price and reach $1.3010 and DM 3.9434. However, expectations that May's money supply figures would be sufficiently improved to permit a cut in base rates, together with reports of a possible Omani oil price reduction, led to profit-taking, particularly against Continental currencies. This continued following a cut in the British National Oil Corporation's price for June oil deliveries and, as the dollar rose on diminished expectations of a relaxation in US monetary policy, sterling fell to lows of ERI 79.2 and $1.2575 on 10 June. As oil price concerns subsided and expectations of lower interest rates receded, sterling recovered. There was no reaction to the ½% reductions in Barclays' and Midland's base rates on 12 June which merely brought them into line with the other clearing banks (at 12½%). The pound advanced to $1.2825 when the dollar dropped sharply following rumours on 14 June that President Reagan had suffered a heart attack. Although it fell back again as the dollar recovered and on news that Mexico had reduced the price of its heavy crude oil, it soon rallied to break the $1.30 barrier which had capped its recent trading range and it reached $1.32 on 19 June. The pound did not remain for long above $1.30, however, and, as the dollar firmed strongly following the release of the second quarter 'flash' US GNP estimate, it fell back on 20 June to $1.27 and also lost ground against Continental currencies. Some good demand gradually re-emerged for sterling, which also received support from the good UK trade figures released on 27 June, and the pound was the main beneficiary when the dollar eased on 28 June on poor US indicators. It breached $1.30 again on 28 June, to finish the month at ERI 81.3, $1.3120 and DM 3.9668.

Sterling moved up to ERI 81.5, $1.3172 and DM 3.9882 on 1 July. Despite some profit-taking and rumours of an agreement at the OPEC meeting to cut official prices for light crude oil, it finally succeeded in sustaining itself above $1.30. Very sizable inflows were attracted, in part in expectation of a large increase in £M3 in June which was seen as likely to require the authorities to maintain the current level of UK interest rates. The pound received further support following the release of the actual figures, which were at the upper end of market expectations, and was only briefly affected by the indecisive conclusion of the OPEC meeting on 5 July. It reached ERI 84.4 (21-month high) and $1.3987 (12-month high), and moved through the DM 4 level to DM 4.0811 on 10 July. At this point, sterling fell back on profit-taking and as cuts in the Bank of England's bill dealing rates rekindled expectations of a reduction in base rates. The ½% cut had been discounted by the time it was eventually announced on 15 July and had no effect on sterling. Increased demand and a weaker dollar following the release of the preliminary second quarter US GNP figure took sterling to a high for the period of $1.4237 on 18 July, before it fell back to $1.4050 by the close, as the dollar rebounded after the US industrial production indicator. As a result of the general uncertainty produced by the suspension of foreign exchange trading in Italy on 19 July, sterling eased to $1.3957 but recovered to close at ERI 84.1, $1.4010 and DM 4.0398 in London. It was again affected by market apprehensiveness on 22 July and retreated to $1.3810. The failure of the dollar to make a sustained recovery following the better than expected US durable goods indicator on 23 July inspired sterling, despite poor UK trade figures, and it advanced to $1.4095 on 26 July before easing quickly to $1.4007 after the ½% cut in the Bank of England's bill dealing rates that day. However, with the dollar under intense selling pressure in New York that evening and more generally on 29 July, the pound met strong new demand and recovered sharply touching a 22-month high of ERI 84.7 and a 15-month high of $1.4315. There was little or no reaction to the ½% cut in base rates by clearing banks, as this had again been discounted. After a brief rally as the dollar continued to weaken in New York, sterling reached $1.4315 again on 31 July, only to fall back in the late afternoon, on rumours that Saudi Arabia would increase its oil output, to finish the month at ERI 83.5, $1.4160 and DM 3.9641.

Prompted by anxiety that UK interest rates might be forced lower by rising unemployment and continuing concern over the oil market (Venezuela was reported to be offering large price discounts), selling of sterling intensified on 1 August and became very heavy as New York started trading. The market became nervous and disorderly, and the pressure on sterling was accentuated by thin trading conditions as many operators withdrew. With massive outflows on investment account and reports of strong corporate demand for dollars and deutschemarks, sterling dropped four cents to touch a low of $1.3732, before closing at ERI 82.1, $1.3845 and DM 3.9029. Sterling had steadied somewhat by the next day, fluctuating erratically in less disorderly, but still very thin, conditions to touch a new low of $1.36. In calmer conditions after 5 August, sterling recovered to $1.3785 but then slipped back again as the dollar firmed. With renewed heavy selling, initially in anticipation of lower UK interest rates in the wake of the fall in £M3 for July, sterling dropped to $1.3262 on 7 August before demand

Changes in UK official reserves
$ millions

	1985		
	June	July	Aug.
Change in reserves	**+340**	**− 62**	**—**
of which:			
Net borrowing (+)/payment (−) of public debt	+216	+ 51	+36
Valuation change on roll-over of EMCF swap	—	−104	—
Underlying change in reserves	+124	− 9	−36
Level of reserves (end of period)	**14,318**	**14,256**	**14,256**

re-emerged and interest rate expectations faded. The pound regained $1.40 on 13 August and then fluctuated around this level, largely reflecting the movements of the dollar, until 30 August, when sterling fell back as the dollar firmed sharply. The pound remained firm against other major currencies, however, to finish the period at ERI 82.7 (+3% over the period), $1.3965 (+8½%) and DM 3.9172 (−⅜%).

Official reserves
Over the three months to end-August, there was an underlying increase in UK reserves of $79 million. Net public sector repayments under the exchange cover scheme totalled $310 million, while $2 million of long-term North American loans was also repaid. The reserves fell by $104 million on account of the valuation adjustment arising from the quarterly roll-over of the United Kingdom's ECU holding with the European Monetary Co-operation Fund swap. At the end of August, the reserves stood at $14,256 million.

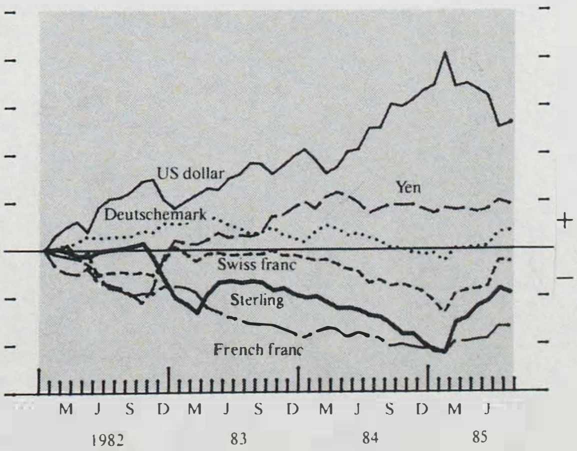
On 16 September, HM Treasury announced a $2,500 million issue of 7-year floating-rate notes in the international capital markets. The purpose of the borrowing was to supplement the official reserves. The issue, which was organised by the Bank of England on behalf of the Treasury and lead-managed by S G Warburg and Credit Suisse First Boston, was the largest FRN to date and was priced on very fine terms; it was nonetheless well received by the market and quickly attracted widespread investment demand, enabling the amount (initially set at $2,000 million) to be increased to $2,500 million.

US dollar
For the first part of the period, the dollar continued to fluctuate erratically within the DM 3–3.10 trading range established in the previous period (although it briefly achieved a high of DM 3.1090 on 10 June). However, sentiment became increasingly bearish as, notwithstanding the unexpectedly strong 'flash' estimates for second quarter GNP (+3.1%; deflator, +3.2%) released on 20 June, the latest series of economic indicators failed to resolve growing doubts about the strength of the US economy and to dampen expectations of some supportive relaxation in Federal Reserve policy. The dollar was also adversely affected by rumours about the state of President Reagan's health and by the ½% cut in US banks' prime rates (to 9½%) on 18 June.

A critical shift in the balance of sentiment occurred on 5 July and the dollar made a sustained descent through DM 3. Its fall was confirmed by further concerns over President Reagan's health. The dollar attempted a brief rally at the end of July and in early August, on a firmer Federal Funds rate and the emergence of optimism over US growth prospects in the second half of the year. There was also some hope of an agreement to reduce the US budget deficit (a reduction in the deficit by then being regarded as a positive factor for the dollar). Underlying sentiment was unmoved, however, and was further depressed by the highly publicised pronouncements of a prominent New York analyst on 9 August that the Federal Reserve was likely to ease its monetary policy stance to try to revive flagging US economic performance. It also reacted little to the expected announcement by the German authorities of a ½% reduction in their official rates on 15 August. A low of DM 2.7350 was recorded on 22 August. At the end of the month, however, the dollar firmed on better than expected economic indicators and following a large increase in M1 (+$2.8 billion), which encouraged the expectation that the Federal Reserve would not consider further relaxation of its policy. Over the period, the dollar lost 8¼%, finishing at DM 2.8050, and lost 5⅜% in effective terms to finish, at 137.5.

EMS
After continuing without apparent strain for the first half of the period, during which the width of the narrow band remained less than 2%, the EMS began to manifest signs of tension in July. The Italian lira, which had continued to be the weakest EMS currency, moved lower within the system. A realignment of the EMS was negotiated over the weekend of 20/21 July. With effect from 22 July, there was a combined devaluation of the lira of 6% and revaluation of the other currencies participating in the exchange rate mechanism of the EMS of 2%, the overall effect of which was to produce a devaluation of the lira's bilateral central rates against the other currencies of about 7⅞%. The bilateral central rates of all currencies in the exchange rate mechanism, other than the lira, remained unchanged. The lira continued at a premium on its new ECU central rate after the realignment, but pressures soon re-emerged within the EMS as the deutschemark

Indices of effective exchange rates
Percentage change since January 1982



and Dutch guilder attracted outflows from the US dollar. At one point, the narrow band touched its $2\frac{1}{4}$% limits before pressures on the system subsided. The EMS finished the period $1\frac{5}{8}$% wide between the Irish pound, which remained at the top for most of the time (occasionally being replaced by the Danish krone) and the Belgian franc, which remained at the bottom throughout.

Other currencies

The yen reflected the dollar's retreat over the period but, as usual, by less than other major currencies, to finish the period at ¥238.90 and 156.5 in effective terms, appreciations of 5% and $1\frac{1}{2}$%, respectively.

The Swiss franc recovered sharply in July as the dollar eased. It then fluctuated erratically to finish the period $10\frac{1}{4}$% higher at Sw.Fcs. 2.3085, and $6\frac{1}{4}$% higher in effective terms at 148.5.

Gold

The gold market fluctuated over the period largely in reaction to the dollar's movements. Events in South Africa had little significant effect on the gold price, which finished at $ 333.25, up $19.25 over the period.