International financial developments

The three-months period to end-November has been marked by two important international policy initiatives—the agreement by the Finance Ministers and central bank Governors of the Group of Five (G5) countries, aimed at redressing the large and growing external imbalances that have developed between some major industrial countries, and the proposal by US Treasury Secretary Baker for fresh efforts to resolve the debt and adjustment problems of a number of less developed countries. The G5 agreement and action taken in furtherance of its aims have had a rapid and substantial impact in the foreign exchange markets, with all major currencies appreciating strongly against the US dollar. By the end of the period, the dollar had depreciated by a little over 8% in effective terms from its end-August level and by about 18% from its February peak.

World current account positions

After a sharp deterioration in the first quarter of the year, the combined current account deficit of the *major seven economies* narrowed appreciably in the second quarter, as some strengthening in Europe and Japan more than offset continuing weakness in the US current balance, and is estimated to have narrowed further in the third. There has, however, been no diminution of the marked imbalances within the aggregate, with the US deficit in particular remaining at the very high level of recent quarters. The *other OECD countries'* combined current account continued to strengthen in the third quarter of 1985, following a modest reduction in the deficit in the second. Against the general trend, the Swedish current account deficit widened further in the early part of the year, but has since fallen back following adjustment measures taken in May.

The *oil exporting countries'* aggregate current account moved further into deficit as continued general weakness of oil export revenue outweighed the effects of import restraint by a number of countries.

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

	1983	1984		1985		
	Year	Year(b)	Q4(b)	Q1(b)	Q2(b)	Q3(b)
OECD economics:						
Canada	1	2	1	1	—	− 1
France	− 4	—	—	− 1	1	—
Germany	4	6	3	2	3	4
Italy	1	− 3	− 2	− 3	− 3	—
Japan	21	35	12	9	12	12
United Kingdom	5	1	1	− 1	1	1
United States	−41	−102	−26	−30	−32	−30
Major economies	−14	− 61	−11	−23	−18	−14
Other OECD	− 9	− 9	− 3	− 2	− 2	− 1
Total OECD	−23	− 70	−14	−25	−20	−15
Oil exporting economies	−18	1	—	—	− 1	..
Other developing economies	−37	− 25	− 4	− 6	− 4	..
Other economies(c)	5	6	1	2	2	..
World discrepancy(d)	−73	− 89	−16	−30	−23	..

.. not available.

(a) Components may not sum to total 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.

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

	1983	1984(a)				1985(a)	
	Year	Year	Q2	Q3	Q4	Q1	Q2
Current account	**−37**	**−25**	**−7**	**− 8**	**−4**	**− 6**	**−4**
Capital account	**34**	**35**	**10**	**9**	**9**	**1**	**5**
of which:							
Concessionary and other official flows	24	25	6	6	6	6	7
Direct investment	8	7	2	2	2	1	2
Borrowing from banks(b)	12	10	3	2	4	−2	2
Borrowing via bond issues	2	3	—	1	1	1	2
Other capital flows(c)	−15	−10	−1	− 2	−4	−5	−7
Official financing balance	**3**	**− 9**	**−3**	**− 2**	**−6**	**5**	**−1**
of which:							
Use of IMF credit	10	4	2	1	1	—	—
Liabilities to other CMIs	− 3	1	—	—	—	—	—
Reserves etc (increase−)	− 4	−15	−5	− 2	−6	4	−1

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

The terms of trade of the *non-oil developing countries* deteriorated markedly in the second quarter of 1985. However, an unexpectedly strong renewal of export growth and falling US interest rates resulted in some improvement in their combined current account.

Capital movements

Capital inflows to the *non-oil developing countries* in the second quarter of 1985 were somewhat larger than in the first quarter and more than sufficient to cover the reduced current account deficit. Net new borrowing from banks in the BIS reporting area was resumed after the decline seen in the first quarter. Portfolio investment also rose, with South East Asian countries, as usual, prominent among non-oil developing countries raising funds by this route. As a result, reserve levels improved slightly, after the sharp decline in the first quarter.

In Seoul in October, on the occasion of the annual meetings of the IMF and IBRD, US Treasury Secretary

Baker launched an initiative aimed at tackling the persisting problems of international indebtedness. The initiative aims at a modest resumption of bank lending to a number of debtor countries, in support of and conditional upon their own comprehensive economic adjustment programmes, with a continued role for the IMF and additional lending by the World Bank and other international agencies. Together, these elements should support sustainable growth in the debtor countries. The parties involved have been discussing how the initiative may best be brought to implementation.

Identified funds deployed by *oil exporting countries* fell by $1.9 billion during the second quarter of 1985. Deposits with banks were reduced by $1.1 billion with large net withdrawals in some areas—mainly from the offshore centres—only partly offset by increased deposits elsewhere, particularly in London. Longer-term investment in the industrial countries fell by a further $1.2 billion, bringing the cumulative net disinvestment in these assets over the twelve months to June to $4.5 billion, suggesting that these countries were seeking to replenish reserves in response to the deterioration in their current account positions.

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

	June 1984 levels	1984 Q3	1984 Q4	1985 Q1	1985 Q2	June 1985 levels	1985 Q3(b)
Industrial countries							
United Kingdom:							
Sterling bank deposits	5.2	0.2	0.1	-0.1	0.1	5.3	0.2
Eurocurrency bank deposits	44.0	0.8	-3.0	—	2.4	43.6	-1.3
Government paper	2.7	—	-0.2	-0.1	0.3	2.8	-0.2
Other investments	6.1	-0.3	—	-0.1	0.1	5.9	-0.1
	58.0	0.7	-3.1	-0.3	2.9	57.6	-1.4
Other EEC:(c)							
Domestic currency bank deposits	4.1	—	—	-0.3	0.3	3.7	..
Eurocurrency bank deposits	19.2	1.2	0.5	1.2	-0.4	21.2	..
Other investments	33.5	-0.5	-0.1	0.5	-0.1	32.3	..
	56.8	0.7	0.4	1.4	-0.2	57.2	..
United States:							
Bank deposits	19.1	0.5	1.6	-0.1	-0.8	20.4	1.2
Government paper	31.7	-0.9	0.5	0.2	0.1	31.6	-2.2
Other investments	33.4	-2.1	-0.2	-0.5	-1.3	29.2	-0.4
	84.2	-2.5	1.9	-0.4	-2.0	81.2	-1.4
Other:							
Domestic currency bank deposits	3.7	0.4	-0.4	-0.5	0.1	3.0	..
Eurocurrency bank deposits	26.6	0.5	0.4	0.5	1.3	29.2	..
Other investments	38.9	1.1	0.9	-1.5	-0.3(b)	38.2	..
	69.2	2.0	0.9	-1.5	1.1	70.4	..
Offshore centres:							
Bank deposits	41.4	-0.1	0.6	1.0	-4.1	38.9	..
Placements with ldcs	59.1	-0.1	0.5	—	-0.2	59.3	..
OEC credit to non-banks	7.5	0.4	—	0.1	0.5	8.5	..
IMF and IBRD(d)	36.8	-0.5	-1.1	0.4	0.1	33.2	0.7
Total identified additions(+)/reductions (-) in deployed assets	**413.0**	**0.6**	**0.1**	**0.7**	**-1.9**	**406.3**	..
Net funds available for deployment		-0.3	1.1	-0.7	-0.5		
of which:							
Net movements in external borrowing etc		*-1.0*	*1.2*	*-0.5*	*0.6*		
Current balance		*0.7*	*-0.1*	*-0.2*	*-1.1*		

.. 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.

Provisional figures for deployment of funds in the United Kingdom in the third quarter suggest that the influx of funds into eurocurrency bank deposits during the second quarter was partly reversed, but it is not yet clear to what extent this represented a net rundown rather than redeployment to other financial centres. In the United States, there was a further rundown of non-banking assets.

International capital markets

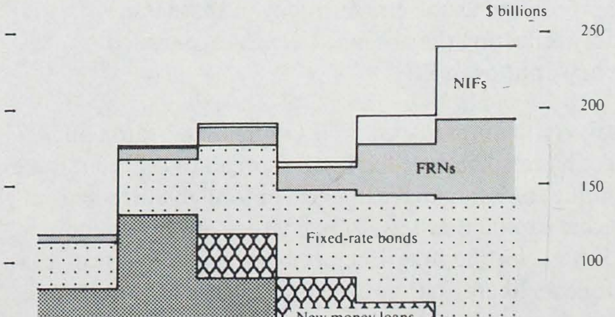
After a quiet August and September, activity in the international capital markets again reached record levels in October and November. The strongest growth was in marketable floating-rate instruments, with both FRNs and euronote facilities far outstripping traditional syndicated credits, the volume of which has continued to decline. Fixed-rate international bond issues were also strong, with signs of some diversification away from the dollar, especially into yen.

UK borrowers have had a strong presence in most sectors of the markets. The United Kingdom raised $2.5 billion, the largest FRN issue to date, to add to reserves; British banks have issued more primary capital FRNs (bringing the total so far to $5.6 billion); British building societies have for the first time issued eurosterling FRNs, raising £825 million; and UK companies have arranged $2.4 billion of euronote facilities.

Fixed-rate bonds

The fixed-rate international bond market continued to expand in the three months to November. Issues completed averaged $9.9 billion a month, compared with an average $8.1 billion over the first eight months of the year. US borrowers raised $7.5 billion during the third quarter, an increase of 40% over the previous three months, although their share of total borrowing (27%) remained almost constant. French borrowers raised $1.4 billion between September and November. A small private placement in yen for Pemex, the Mexican oil agency, was the first new bond issue for a Mexican state

International capital market activity
1985 first eleven months at annualised rate



Completed international bond issues[a]

$ billions; *percentages in italics*

	1984		1985				
	Q3	Q4	Q1	Q2	Q3	Oct.	Nov.
Fixed-coupon bonds							
Borrower:							
Major OECD countries	10.1	14.6	17.5	12.9	18.3	5.5	8.3
of which:							
United States	3.8	8.0	8.1	5.4	7.5	2.4	3.9
Japan	3.5	2.9	5.6	3.8	5.1	1.2	1.9
Minor OECD countries	2.9	4.1	3.3	4.5	4.2	1.7	1.9
International institutions	3.0	4.2	3.4	2.8	4.4	1.6	1.5
Other	0.5	0.6	0.5	1.0	0.8	0.4	—
Total	**16.5**	**23.5**	**24.7**	**21.2**	**27.7**	**9.2**	**11.7**
Currency:							
US dollars	*52.6*	*56.3*	*55.3*	*45.3*	*47.2*	*35.8*	*53.2*
Swiss francs	*17.0*	*9.8*	*12.6*	*12.0*	*11.0*	*8.9*	*18.6*
Yen	*7.6*	*10.0*	*9.7*	*10.8*	*11.4*	*22.8*	*5.0*
Other	*22.8*	*23.9*	*22.4*	*31.9*	*30.4*	*32.5*	*23.2*
Floating-rate notes							
Borrower:							
Major OECD	5.7	7.2	7.0	7.9	7.9	6.2	4.9
Minor OECD	2.0	2.8	1.5	3.4	1.6	0.2	0.4
Other	0.4	1.4	1.5	2.1	2.6	0.7	0.1
Total	**8.1**	**11.4**	**10.0**	**13.4**	**12.1**	**7.1**	**5.4**

(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.

agency since the moratorium on the country's debt servicing was declared in August 1982.

The proportion of issues denominated in dollars fell from 46% in September to 36% in October. During the third quarter, the most evident counterpart to the declining appeal of the dollar was the popularity of issues in less widely traded currencies (notably Australian and New Zealand dollars) to take advantage of currency swap opportunities. This trend towards less widely traded currencies continued during October and November with the first issues in eurolire and the first for a foreign borrower in Irish pounds.

The decline in the dollar's share of borrowing was partly balanced by a rise in yen issues (to 15% of the total in September–November). This included twenty-five issues, totalling $2.56 billion, of a new type of dual-currency bond: these bonds carry a face value and coupon denominated in yen, but are repayable in dollars at an exchange rate determined at the time of issue. Other issues have been made whose redemption value changes depending on the yen/dollar exchange rate; and others, with warrants attached, offer conversion into bonds or floating-rate notes denominated in another currency. The ECU has been prominent as the end currency in these issues, possibly reflecting the absence of exchange-traded currency options in ECU.

The diversification of currencies in the fixed-rate bond market has also been aided by the spread of different issue techniques and the increasing use of foreign currencies in domestic capital markets. Public issues of zero-coupon bonds have for the first time been made in Swiss francs: this follows liberalisation measures during May and June in West Germany and in Japan which authorised the issue of zero-coupon bonds in those markets. There have also been dollar-denominated fixed-rate bond issues in Tokyo and yen-denominated issues in New York.

Floating-rate notes

FRN issues in September totalled $2 billion, bringing the total for the third quarter as a whole to $12 billion. The volume of issues completed in October and November rose to $12.5 billion; this included $2.5 billion raised by the United Kingdom—the largest FRN to date. The proportion of FRNs denominated in dollars was under 90% between September and November, primarily reflecting a rise in the number of issues in sterling and deutschemarks. Six UK building societies announced sterling FRNs (the societies are limited to the sterling market) totalling £825 million; the bonds will rank above ordinary shares in the event of liquidation.

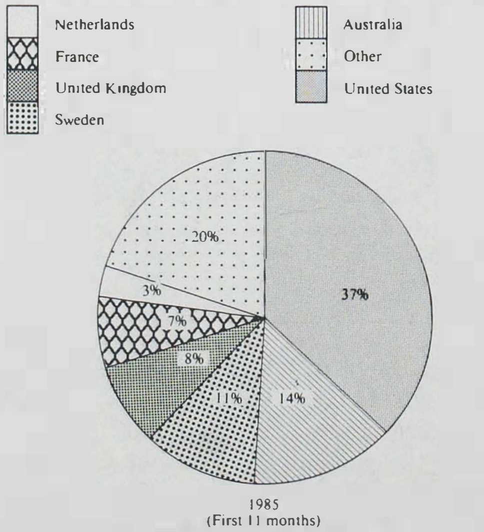
Repackaging of FRNs has been another field of innovative activity. Banks have sought to convert perpetual FRNs issued prior to the announcement of regulations governing the primary capital status of this form of borrowing to make them comply with those regulations. In addition, parts of the United Kingdom's FRN were repackaged by banks in three separate issues which incorporated an interest rate swap to create fixed-rate bonds backed by holdings of the notes.

Banks have continued to account for the largest share of FRN issues. Between September and November, a further $2.1 billion of perpetual FRNs that satisfy the Bank of England's requirements on primary capital were issued by six British banks. And between September and November, twenty-one FRN issues were completed by US banks, raising $3.5 billion; this included a number of issues for some of the stronger savings and loans institutions.

Euronote facilities

This section describes facilities for the issue of short-term euronotes, whether or not backed by bank commitments. The third quarter was a quiet period for new euronote facilities, with announcements down nearly 50% on the second quarter to $8.0 billion. October and November, however, saw an upturn, with announcements of $12.8 billion. Corporate borrowers continue to account

NIFs by country of borrower: percentage shares



1985
(First 11 months)

Announced euronote facilities(a)
$ billions

	Underwritten(b)	Non-underwritten	Total	*of which.* Major OECD	Minor OECD	Other
1982	2.37	—	**2.37**	*0.53*	*1.16*	*0.68*
1983	3.29	—	**3.29**	*1.72*	*1.25*	*0.32*
1984	18.24	0.69	**18.93**	*6.41*	*11.24*	*1.28*
1984 Q3	3.89	0.12	**4.01**	*0.80*	*3.00*	*0.21*
Q4	7.52	0.53	**8.05**	*4.79*	*2.34*	*0.92*
1985 Q1	7.70	0.60	**8.30**	*4.86*	*3.05*	*0.39*
Q2	11.44	3.43	**14.87**	*9.47*	*4.23*	*1.17*
Q3	5.06	2.92	**7.98**	*4.22*	*3.34*	*0.42*
1985 Oct.	3.75	1.86	**5.61**	*3.14*	*2.29*	*0.18*
Nov.	4.03	3.11	**7.14**	*5.12*	*1.54*	*0.48*

(a) Revised data. Includes all facilities providing for the issue of euronotes (including note issuance facilities, revolving underwriting facilities, multiple component facilities which incorporate a note issuance option, and eurocommercial paper programmes).
(b) Underwritten or otherwise backed by bank commitments.

for the greater part of new facilities, taking 78% of the total in the third quarter (compared with 65% in the second) but 64% in October and November. The most active borrowers were those from OECD countries, particularly the United States, Australia and the United Kingdom. US corporations arranged facilities worth $1.8 billion in the third quarter and $4.8 billion in October and November; Australian borrowers $1.7 billion and $2.2 billion; and UK borrowers $1.0 billion and $1.4 billion.

Some non-OECD countries, including borrowers from South Korea, Singapore, India and Malaysia, have also been able to arrange facilities; Hungary, diversifying away from the syndicated credits market like other borrowers, has arranged its first facility.

Although drawings under euronote facilities are still only a fraction of the nearly $70 billion of facilities now in place (most estimates of the value of paper in issue are in the $10–$15 billion range), there is evidence that the number of drawings is increasing and that a secondary market is becoming established.

Two fairly recent developments in the structure of facilities are now widespread. The first is that most facilities now include borrowing options additional to the issue of euronotes. Although it would appear that most drawings are at present in the form of dollar-denominated euronotes (with some bankers' acceptances and short-term advances), it seems that many facilities include options which are not planned to be used immediately but which may come into play later on in the life of the facility. The second is that a large number of other facilities are not underwritten or backed by a standby credit. In the third quarter and in October and November, 35% of facilities took this form (known generally as 'eurocommercial paper programmes').

Syndicated lending

Borrowing in the syndicated credits market has continued to decline, with total announcements, at only $4.5 billion for the third quarter, the lowest quarterly total since 1975, when the market was in its infancy. Announcements in October and November were just $2.2 billion. Banks' commitments under rescheduling and new money packages were $4.2 billion in the third quarter, $1 billion less than in the previous three months.

There appears at the moment to be little prospect that the market will regain its former role in international financing. Although historically low spreads and loan participations which are more easily transferable might be expected to have enhanced the attractions of the market to prospective borrowers and lenders respectively, there continues to be a shift by nearly all categories of borrowers away from syndicated credits towards FRNs and euronote facilities. With lenders previously active in the credits market building up their securities capabilities and winding down their syndication operations, a return to high levels of activity in the credits market seems unlikely.

Recent borrowing activity by OECD countries has largely taken the form of the renegotiation and refinancing of existing loans, although borrowers from Italy, Portugal and Turkey have continued to arrange new loans. Access to the market by developing countries remains limited to a small group of countries, mostly from South East Asia, with South Korea by far the largest borrower (raising $650 million in the third quarter and $250 million in October and November). Eastern bloc countries have become among the heaviest and most favoured borrowers; they raised $750 million in the third quarter and $400 million in October and November.

Announced syndicated credits(a)
$ billions

	Major OECD	Minor OECD	Developing countries	Eastern bloc	Other	Total	*of which, transferable*
1982	23.69	18.39	31.41	0.51	15.26	**89.26**	—
1983	8.16	13.58	8.66	0.55	7.17	**38.12**	—
1984	9.90	6.16	7.17	2.19	4.69	**30.11**	*1.49*
1984 Q3	3.57	1.85	1.65	0.58	0.96	**8.61**	*0.32*
Q4	1.12	1.71	1.48	0.60	1.64	**6.55**	*0.67*
1985 Q1	1.70	1.66	1.20	0.64	0.49	**5.69**	*1.58*
Q2	0.86	1.39	1.35	1.74	0.26	**5.60**	*1.02*
Q3	1.10	0.86	1.29	0.71	0.54	**4.50**	*1.62*
1985 Oct.	0.36	0.21	0.26	0.25	0.06	**1.14**	*0.07*
Nov.	0.75	0.12	0.06	0.14	—	**1.07**	*0.03*

(a) Excludes new money loans arranged in the context of debt restructuring agreements.

In recent quarters there has been an increase not only in the proportion of loans incorporating some form of transferability but also in the proportion having multicurrency options (ie expressed in dollars but drawable in a range of currencies). The opening up of the euroyen loan sector (with large loans for borrowers from South Korea and Thailand) and continued interest in ECU-denominated loans have led to a fall in the share of new business denominated in dollars, although it is still by far the most used currency.

International banking developments

This section assesses the international business of banks in the BIS reporting area and, separately, of banks in the United Kingdom.

Banks in the BIS reporting area (second quarter of 1985)
There was a marked slowdown in the growth of BIS-area

banks' external lending in the second quarter, after the exceptional first quarter rise in interbank business. The slowdown was accounted for entirely by a fall in interbank business, with seasonal operations by the Japanese banks being the main factor behind the contraction.

Lending to outside-area countries grew modestly after a fall in the first quarter. About two thirds of the increase in outstanding claims represented new lending to East European borrowers who have returned to the syndicated credits market in some force this year. Lending to the developed countries outside the BIS area and to the non-oil developing countries in aggregate rose modestly but there was no change in claims on Latin America. This reflects the absence of any new 'package' money in the second quarter. Estimated international lending to final users, a measure which includes external lending and foreign currency claims on residents, rose by only $15 billion for the second successive quarter (compared with growth of $30 billion in the second quarter of 1984).

External business of banks in the BIS reporting area
$ billions; changes exclude estimated exchange rate effects

	1983	1984	1985		Outstanding at end-June 1985
	Year	Year	Q1	Q2	
Deposits from					
Outside reporting area:					
Developed countries	+ 2	+ 3	—	+2	31
Eastern Europe	+ 3	+ 4	− 3	+2	22
Oil exporting countries	− 14	+ 2	+ 1	—	149
Non-oil developing countries	+ 10	+ 20	− 1	—	169
of which, Latin America	*+ 6*	*+ 10*	—	—	*68*
Sub-total	+ 1	+ 29	− 4	+4	370
Inside reporting area(a)	+105	+117	+65	−4	1,781
Unallocated	+ 5	− 1	− 1	—	52
Total	**+111**	**+145**	**+60**	**—**	**2,203**
Lending to					
Outside reporting area:					
Developed countries	+ 7	+ 6	+ 1	+2	92
Eastern Europe	− 1	—	− 1	+4	51
Oil exporting countries	+ 10	− 2	− 1	−2	104
Non-oil developing countries	+ 12	+ 10	− 2	+2	333
of which, Latin America	*+ 8*	*+ 6*	*− 1*	—	*212*
Sub-total	+ 28	+ 14	− 2	+6	580
Inside reporting area(a)	+ 74	+106	+55	−1	1,609
Unallocated	− 4	—	+ 1	+1	45
Total	**+106**	**+120**	**+53**	**+6**	**2,234**

(a) Including non-reporting offshore centres.

The currency diversification of international banking flows has been even more marked than that of new funds raised in the international capital markets. In the second quarter of 1985 the share of dollar-denominated lending fell again, with external dollar claims contracting after only a small increase in the first quarter. Sterling and Swiss franc business also declined after rapid first quarter growth, while yen and deutschemark business expanded. Nevertheless, at end-June 1985 the dollar still accounted for just over two thirds of outstanding claims, with sterling representing only 3% of the total.

There was no overall change in external deposits with banks in the BIS area. A fall in deposits from within the BIS area was offset by a moderate rise in deposits from outside-area countries. All of this rise, however, came from the 'other developed' countries and Eastern Europe. There was no change in the level of deposits from the non-oil developing countries, despite a modest overall rise in their foreign exchange reserves.

The London market (third quarter of 1985)
After modest growth in the first half of the year, international lending by banks in the United Kingdom grew more strongly in the third quarter of 1985. More than half of the rise was accounted for by foreign currency business in the UK interbank market. At the same time, external lending that can be allocated geographically (shown in the accompanying table) and 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) also rose with some strength.

In a quarter in which they traditionally expand their balance sheets, Japanese banks accounted for most of the overall growth of business in London. British banks' international balance sheets also rose substantially.

Dollar-denominated lending increased in the third quarter, having fallen absolutely in the first and second quarters, and accounted for almost three quarters of new external claims in the period. The deutschemark was the second most popular currency of denomination. Yen loans again grew rapidly but at a slower pace than in the first half of the year. Lending in sterling fell for the second successive quarter, although the cumulative decrease is small compared with the rapid growth in the first quarter.

Most of the increase in external lending was accounted for by interbank transactions within the BIS area, principally lending by Japanese banks in London. The modest upturn in lending to other countries recorded in the second quarter continued into the third quarter but the statistics significantly overstate the strength in the

External business of banks in the United Kingdom
$ billions; changes exclude estimated exchange rate effects

	1984			1985		
	Year	Q3	Q4	Q1	Q2	Q3
Deposits from:						
BIS reporting area(a)	+25.3	−0.6	+5.6	+12.7	+0.5	+13.8
Offshore banking centres(b)	+ 7.4	+0.1	+1.3	+ 3.4	−0.1	+ 0.9
Sub-total	+32.7	−0.5	+6.9	+16.1	+0.4	+14.7
Developed countries	+ 1.6	+0.6	+0.4	+ 0.3	+0.5	+ 1.2
Eastern Europe	+ 0.9	−0.6	+1.2	− 0.8	+0.7	+ 0.7
Oil exporting countries	− 1.1	+1.0	−2.9	−0.1	+2.4	− 1.1
Non-oil developing countries	+ 4.7	−1.9	+1.4	− 0.6	+0.1	− 1.6
of which, Latin America	*+ 2.8*	*+0.3*	*+0.4*	*− 0.2*	*−0.7*	*− 0.5*
Sub-total	+ 6.1	−0.9	+0.1	− 1.2	+3.7	− 0.8
Others	− 2.6	−0.8	+0.4	− 0.2	+0.8	+ 0.2
Total	**+36.2**	**−2.4**	**+7.4**	**+14.7**	**+4.9**	**+14.1**
Lending to:						
BIS reporting area(a)	+15.2	−3.4	+4.1	+ 8.4	−4.7	+12.4
Offshore banking centres(b)	+ 9.3	+1.3	−1.0	+ 0.2	+1.0	− 3.7
Sub-total	+24.5	−2.1	+3.1	+ 8.6	−3.7	+ 8.7
Developed countries	+ 1.2	+0.2	+0.4	+ 0.5	+0.4	—
Eastern Europe	− 0.4	—	−0.1	− 0.1	+1.1	+ 1.3
Oil exporting countries	− 1.0	−0.9	−0.7	+ 0.1	−0.3	− 0.5
Non-oil developing countries	+ 1.1	−0.4	−0.2	− 0.8	+1.0	+ 1.9
of which, Latin America	*+ 1.9*	*+0.1*	*+0.4*	*− 0.3*	*+0.1*	*+ 1.8*
Sub-total	+ 0.8	−1.1	−0.6	− 0.3	+2.2	+ 2.7
Others	—	−0.6	+0.1	+ 0.5	+0.7	+ 1.6
Total	**+25.3**	**−3.8**	**+2.6**	**+ 8.8**	**−0.8**	**+13.0**

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

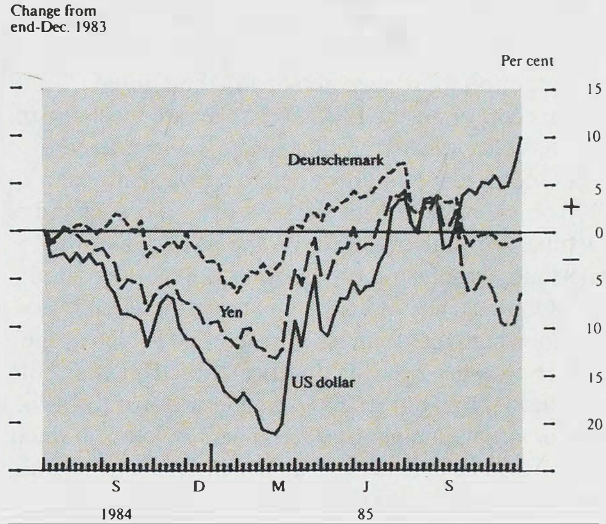
latest period. The increase in lending to Latin America does not in fact represent new lending; in the quarter, Crocker National Bank's exposure to Latin American debtor countries was sold to Midland Bank in London as part of the group's restructuring of its international debt. All of the real growth in lending to outside-area countries in the third quarter was to Eastern European borrowers, whose return to the international capital markets is now well established.

Over two thirds of the rise in the external deposits of banks in the United Kingdom in the third quarter was attributable to interbank operations with the main financial centres. There was also a large rise in deposits by non-banks in the BIS reporting area. Deposits by both the oil and non-oil developing countries dropped, reversing the growth recorded in the second quarter. Within the non-oil group, Latin American deposits with banks in the United Kingdom fell for the third consecutive quarter, after having risen continuously for over two years up to the end of 1984. In contrast, liabilities to Eastern bloc countries rose again and the increase in deposits by developed countries accelerated.

Foreign exchange and gold markets

This section reviews the three months to end-November.
The principal development affecting the exchange markets in the period under review was the agreement reached by the Finance Ministers and central bank Governors of the Group of Five (G5) industrial countries at their meeting in New York on 22 September. In a joint statement presenting common views on the world economy and foreign exchange markets (which was accompanied by individual policy statements), the G5 expressed the belief that exchange rates should better reflect fundamental economic conditions in order to play a role in adjusting external imbalances and indicated a readiness to co-operate more closely to encourage some further orderly appreciation of major currencies against the dollar when to do so would be helpful. The result of the G5 communiqué was an immediate sharp fall in the value of the dollar against all major currencies. This impact was subsequently reinforced by central bank intervention and by a tightening of Japanese monetary policy in October. The downward trend of the dollar was confirmed by the emergence of expectations of a cut in the US discount rate aimed at sustaining the momentum of the US economy. Sterling rallied strongly following news of the G5 agreement but subsequently lost some ground on oil price worries and on rumours that the United Kingdom was about to enter the exchange rate mechanism of the European Monetary System (which it was supposed would involve a lower cross-rate against the deutschemark). However, as the likelihood of full UK participation in the EMS receded, and helped by expectations that UK interest rates would remain firm, sterling recovered by the end of the period to reach a 21-month high against the dollar.

Sterling against selected foreign currencies



Sterling

The pound opened the period on 2 September at ERI 82.3, $1.3840 and DM 3.9098 in London. As the dollar strengthened, sterling eased to $1.3635 in New York on 3 September. It initially remained firm against Continental currencies but, on 6 September, encountered heavy selling, which was apparently motivated by oil price concerns following the reported break with OPEC pricing policy by Saudi Arabia. The pound was marked down to ERI 79.2 and $1.2950 on 9 September. Although it quickly re-established itself above the $1.30 level, it continued to exhibit nervousness to news and rumour, particularly about oil prices, and fell back to touch a low of $1.2940 on 12 September. Sterling's weakness was then alleviated by a fall in the dollar and by oil supply concerns following the intensification of fighting in the Gulf. The pound advanced, although still reacting nervously to oil news, to reach $1.3740 in New York on 20 September. It also briefly moved up through DM3.90. Following news of the G5 meeting on 22 September, sterling's recovery accelerated sharply and it reached $1.4480 on 23 September. Profit-taking took the pound off its best, however, and it stabilised at about $1.43, although occasionally making rallies back up to about $1.4460. It was then undermined by the emergence of rumours that the United Kingdom was about to assume full participation in the EMS (at a lower rate against the deutschemark) and was also affected by the Confederation of British Industry's renewed calls for a lower deutschemark rate. It met selling, at times heavy, against Continental currencies and the yen and, in volatile and erratic conditions, was forced down several times through $1.40. An official denial of the EMS rumours on 30 September and the unexpected failure of the New York market to open (because of a hurricane) provided only temporary relief, and sterling eased to lows of ERI 79.6 and $1.3910, before closing the month at ERI 80.2, $1.4070 and DM3.7602.

Sterling began to recover ground against the dollar at the start of October, to reach $1.4360 on 4 October, but was further depressed against Continental currencies by the persistence of EMS rumours as the New York market focussed on the Chancellor's (long-standing) decision not to attend the IMF/IBRD Annual Meetings and saw in this his intention to oversee personally the United Kingdom's entry into the EMS exchange rate mechanism. Sterling was also affected by nervousness engendered by the OPEC conference and dropped to a low of almost DM3.70 on 4 October. With the passing of the weekend of 5–6 October without any move on the EMS, it assumed a firmer tone. Despite a more buoyant dollar, the pound remained fairly steady at about $1.41 and made up losses against Continental currencies to reach DM3.7766 at the close on 16 October. Sterling briefly assumed a softer note as the dollar rallied, but received a general boost from the Chancellor's Mansion House speech on 17 October which was interpreted as indicating that UK interest rates would remain firm for at least the immediate future. Good demand took sterling back up to $1.44 and DM3.7812 on 21 October, after which it moved onto the sidelines and, in generally dull and featureless trading, largely mirrored movements in the dollar, to close on 31 October at ERI 80.9, $1.4451 and DM3.7734.

Oil price worries surfaced again on 1 November following reports of UAE Oil Minister Oteiba's statement that OPEC members were now free to fix their own oil prices. Selling in the Far East took sterling to $1.4275 and DM3.7268 at the low point. A rebuttal of Oteiba's remarks by OPEC Chairman Subroto helped sterling regain ground against the dollar, but it continued to drift down against Continental currencies. After reaching $1.4440 on 4 November, the pound fell back again, as the dollar rallied on reports from Japan of a change in intervention policy, and on further oil price worries, to DM3.7045 in London on 7 November and $1.4080 in New York on 8 November. Sterling remained somewhat depressed following Saudi Oil Minister Yamani's forecast of an oil price war next year if production remained unchecked. It began to recover from the middle of the month, helped by press speculation that UK interest rates would remain high for the foreseeable future and an interview with the Prime Minister in which early entry in the EMS exchange rate mechanism was ruled out. Following the publication of a report by the Treasury and Civil Service Select Committee which decided against the advisability of full EMS participation by the United Kingdom in the short term, sterling moved through the $1.45 level on 22 November. Despite a brief set-back on further bearish statements on oil prices by Yamani and weaker spot oil prices, interest rate considerations made sterling a main beneficiary of the outflows from the dollar at the end of the month and it was traded up to a 21-month high of $1.4930 on 29 November before finishing the period at ERI 81.3 (−1¾% over the period), $1.4904 (+6¾%) and DM3.7446 (−4¾%).

Official reserves

Over the three months to end-November, there was an underlying decrease in UK reserves of $622 million. Net public sector borrowing under the exchange cover scheme totalled $40 million. The reserves also received the

Revision of the currency amounts in the SDR basket

The International Monetary Fund has recently undertaken a review of the list of currencies and the weights attached to them in the basket used to calculate the official value of the SDR, in accordance with its decision of 17 September 1980 that the valuation basket should normally be reviewed with effect from 1 January 1986 and on the first day of each five-year period thereafter. The review is intended to ensure that the SDR basket includes the currencies of the five member countries of the Fund with the largest exports of goods and services during the five-year period preceding the revision—in the present case, 1980–84. The weights of the currencies in the basket are intended to reflect the relative importance of these currencies in international trade and finance during this period and are, therefore, based on the value of the exports of goods and services of the members issuing these currencies and the amounts of their currencies officially held by members of the Fund. The changes to take effect on 1 January 1986 are shown below:

Currency	**Current basket weight**	**New basket weight**
US dollar	42	42
Deutschemark	19	19
Japanese yen	13	15
French franc	13	12
Pound sterling	13	12

The list of currencies is the same as that used since 1 January 1981 (when the list was reduced from 16 currencies, see March 1981 *Bulletin,* page 66).

It should be noted that the weights indicated above are not used directly in the daily calculation of the value of the SDR. This valuation is done using nominal amounts of each currency which are determined from the weights. The weights are translated into the requisite amounts of currency on the last Fund business day before a new review comes into effect and remain fixed until the next review comes into effect (between reviews, therefore, the weight of each currency varies from day to day depending on its exchange rates against the other basket currencies). The currency amounts that will come into effect from 1 January 1986 will be fixed on 31 December 1985. The currency amounts will be calculated in a manner that will ensure that, at the average daily value of the SDR against each basket currency over the last three months of 1985, the amount of each currency will correspond to the prescribed weights and that the value of the SDR against each basket currency on the day of the calculation will be the same on the basis of both the current and the new basket.

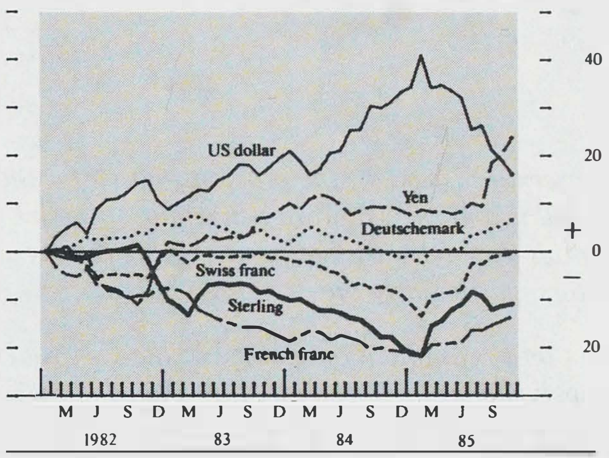
Changes in UK official reserves
$ millions

	1985		
	Sept.	Oct.	Nov.
Change in reserves	**-80**	**+2,134**	**-334**
of which:			
Net borrowing (+)/payment (-) of public debt	+17	+2,650	-133
Valuation change on roll-over of EMCF swap	—	- 192	—
Underlying change in reserves	-97	- 324	-201
Level of reserves (end of period)	**14,176**	**16,310**	**15,976**

proceeds of HM Government's $2,500 million issue of 7-year floating-rate notes. There was a fall of $192 million in the reserves 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. At the end of November, the reserves stood at $15,976 million.

US dollar
The dollar experienced a major downward adjustment over the period. This occurred, against a background of growing doubts about US economic performance, following the announcement of the G5 agreement, initially in anticipation of central bank intervention and then by its realisation, backed up by a tightening of monetary policy in Japan. The leading role played by the Japanese authorities in the G5 action was reflected in a particularly sharp drop in the dollar against the yen, from a high of ¥244.15 in London on 12 September and ¥238.57 at the close in New York on 20 September, just before the G5 meeting, to ¥201.60 in the Far East on 7 November. The dollar also fell from a high of DM2.9805 on 12 September and DM 2.8405 at the close in New York on 20 September to DM2.5892 on 4 November. Nonetheless, the dollar at times displayed considerable resilience, particularly at about the DM2.60 level, from which it rebounded to DM2.6925 between 9 and 16 October, despite central bank intervention. Such rallies by the dollar appeared to have been encouraged largely by official statements which cast doubts on the continued aggressiveness of G5 central bank intervention. They were contained and reversed by further official dollar sales, supported by the reiteration of G5 commitment to further exchange rate adjustments and, in late October, by the increase in Japanese short-term interest rates engineered by the Bank of Japan (the impact of which was accentuated by a misinterpretation of movements in German short-term interest rates which led to rumours of a G5 interest rate accord). However, the dollar was undermined and its downward trend maintained by the emergence of expectations of a US discount rate cut to support the level of economic activity in the United States. These expectations, encouraged by the perception of greater official tolerance of above-target money supply growth, at least under current circumstances, forced the dollar down to a five-year low of ¥199.80 in the Far East on 25 November and DM2.5040 on 29 November. Over

Indices of effective exchange rates
Percentage change since January 1982



the period, the dollar depreciated by $10\frac{3}{8}$% to DM2.5125 and by $8\frac{1}{8}$% in effective terms to 126.3. From the close in New York on 20 September, just before the G5 meeting, the dollar lost $11\frac{1}{2}$% against the deutschemark, $15\frac{3}{8}$% against the yen and $9\frac{1}{2}$% in effective terms.

EMS
The EMS remained free of tensions over most of the period, with the narrow band staying well within 2%. However, at the end of the period, the sharp appreciation of the deutschemark placed sudden strains on the system and the narrow band widened to finish the period $2\frac{1}{8}$% wide. The French franc replaced the Irish pound at the top from the start of September, while the Belgian franc remained at the bottom throughout the period. The Italian lira, which started the period about $2\frac{1}{4}$% above the weakest currency in the narrow band, fell back in the middle of September to just above the top of the band and entered it as the lira eased, following the resignation of the Italian government on 17 October: it then fell back again at the end of November as the deutschemark firmed sharply, to finish the period $1\frac{1}{8}$% above the weakest currency.

Other currencies
The yen appreciated over the three months to end-November and gained $15\frac{1}{2}$% against the dollar to finish at ¥202.00, and $13\frac{1}{4}$% in effective terms to 177.2.

The Swiss franc firmed by $9\frac{7}{8}$% against the dollar over the period to Sw. Fc. 2.0810, and by $2\frac{1}{2}$% in effective terms to 152.3.

Gold
The gold market was quiet with the price largely reflecting movements in the dollar, although activity in the silver market helped it to trade up to $332 on 4 October. In the later part of the period, the gold market was affected by concerns about the standing of traders also involved in tin dealings. The final fixing in London in November was $325.30, down $7.95 over the period.