

International banking in London, 1975–85

Using the comprehensive statistics available since the mid-seventies, this article⁽¹⁾ reviews international banking in the United Kingdom in the decade to 1985.

- *Despite the growth of new competitors, the United Kingdom has retained a leading role in the international banking markets, particularly in eurocurrency activity.*
- *While the number of banks represented in London has grown considerably, most of the international business continues to be booked by a small number of large banks.*
- *Developments in London fully reflect the more general expansion of Japanese banks in the international arena, and the corresponding reduction in American banks' involvement.*

Introduction

London was well established as the centre of international banking and capital markets by the second half of the nineteenth century. The international lending booked by banks in London was mainly traditional foreign lending—sterling advances to finance overseas trade—and the bankers specialising in international business were drawn from a large number of countries. In 1875, the year when the Report from the Select Committee on Loans to Foreign States was published, the governments of Brazil, Chile, Russia, Spain, Sweden and the State of Massachusetts—a small proportion only of the regular sovereign borrowers—issued securities on the London market.⁽²⁾ One hundred years later, London was still the major centre of international banking and capital market activity. But by 1975 banks' traditional foreign lending in sterling was dwarfed by eurocurrency transactions, the list of sovereign borrowers had lengthened very considerably following the fourfold rise in oil prices in 1973 and 1974, and the international banking community had grown even more cosmopolitan.

At the same time, 1975 was the beginning of what might be described as the new statistical era for international banking in the United Kingdom. In late 1974 the Bank of England introduced an integrated set of statistical returns, comprising a central balance sheet and related, consistent, subsidiary forms.⁽³⁾ From that date, the international business of banks located in the United Kingdom was identified more accurately and more completely than before. The new system was fully tested by the end of 1975 and the data were computerised at this stage—hence this article uses statistics from end-1975 to end-1985. The returns collected since the mid-seventies form a comprehensive statistical record of international banking in the United Kingdom in a decade of unprecedented growth and change.

It seems appropriate now, at a time when direct lending through the international securities markets has resumed a position of central importance in international capital flows, to look back on the 'recycling era', when bank intermediation assumed the dominant role. The recent behaviour of banks and the attitudes of supervisory authorities are best understood as reactions to the earlier rapid increase in banks' contributions to balance of payments financing, and the debt servicing difficulties which followed the second round of oil price rises and the related slowdown in world growth and trade. Heightened concern about the quality and liquidity of international assets, moves to strengthen capital bases, efforts to expand off balance sheet business and many other developments of the eighties may usefully be viewed against the background of the recycling years.

Although London also plays a leading role in the international capital markets—being the centre of eurobond activity and a major location for the arrangement of note issuance facilities, interest rate and currency swaps and forward rate agreements—this article is confined to the international banking activity reflected in banks' balance sheets. Being primarily a statistical analysis, it does not address the question of why London developed and retained its position as a leading international banking and financial centre. What is clear from the statistical record is that the combined effect of London's historical importance, a regulatory environment sympathetic to the pursuit of international banking, and the time zone advantages of the related foreign exchange markets have convinced the world's largest banks, and many of medium and small size, of the value of representation in London.

As used throughout the article, international banking business refers to all banking transactions in foreign

(1) Written by Andrew Lamb of the Bank's Financial Statistics Division.

(2) Leland Jenks. *The migration of British capital to 1875*. London: Nelson, 1971 (first published New York, 1927), page 424.

(3) The new statistics and the need for change are described in the June 1975 *Bulletin*, pages 162–5.

currency—cross-border and with local residents—and cross-border transactions in domestic currency (sterling). This is the widest definition of international banking business and the one used by the Bank for International Settlements. The term is sometimes used in a narrower sense, for example by the International Monetary Fund in their *International Banking Statistics*, to refer to cross-border transactions alone, to the exclusion of foreign currency business with local residents. The United Kingdom and London are used interchangeably, for purely stylistic reasons, throughout the text: international banking business in the United Kingdom is in fact firmly centred in London but is also booked in other mainland cities, and in the Channel Islands and the Isle of Man, which are also covered by the statistics. In similar fashion, although the term 'banks' is employed throughout, the statistics relate both to banks and to other authorised institutions under the 1979 Banking Act.

Most of the data examined in the article begin at end-1975. By that date, the international banking markets, and more particularly the interbank markets, had settled down after the problems associated with the collapse of Franklin National and Bankhaus Herstatt in mid-1974. The article begins with a brief survey of the structure of international banking in London at end-1985, the end of the ten-year period under review. This serves as background to the assessment of growth, development and change in the preceding ten years.

International banking in London at end-1985

At the end of 1985, banks located in the United Kingdom, that is British-owned banks and the branches and subsidiaries of foreign banks, held just under a quarter of the international claims booked in countries reporting to the BIS.⁽¹⁾ Their market share was almost twice that of banks in the United States, whose position as the second largest centre is under challenge from Japan, and the world's largest one hundred banks were all represented in London. London's share of eurobanking activity, narrowly defined as cross-border lending in foreign currencies, was rather higher at 30%, and its leadership more pronounced, with Paris, the second most important centre, having only 8% of the market. The eurobusiness is conducted mainly in dollars, but other currencies have been increasingly important in recent years. Sterling lending to overseas residents, the basis of international banking in London until the emergence of the euromarkets in the late 1950s, accounted for less than 7% of outstanding cross-border claims and under 6% of international claims at the end of 1985.

The range of countries whose banks are represented in London is now exceptionally wide (Table A). Sixty-three countries have direct representation in London through a licensed deposit-taking institution or recognised bank.

Table A
Geographical origins and status of foreign banks established in London: end-December 1985

Country of ownership	Representative offices	Branch operations	Consortium banks	Subsidiary operations	Total
Western Europe:					
Austria	1	3	—	—	4
Belgium	—	3	—	1	4
Denmark	1	2	—	2	5
Finland	1	2	—	1	4
France	8	11	1	2	22
Germany, Federal Republic	3	14	1	—	18
Italy	10	10	1	2	23
Luxembourg	4	2	1	—	7
Netherlands	2	6	—	1	9
Norway	3	—	—	1	4
Portugal	2	3	—	—	5
Spain	8	5	—	2	15
Sweden	4	—	—	3	7
Switzerland	7	9	—	2	18
Others	6	13	—	7	26
Sub-total	60	83	4	24	171
Eastern Europe	10	2	2	2	16
Japan	15	24	2	2	43
North America:					
Canada	2	6	—	4	12
United States	16	43	2	19	80
Caribbean					
Latin America	7	1	—	1	9
Latin America					
	16	9	4	—	29
Middle East	15	20	6	2	43
Rest of the World:					
Australia	1	10	—	4	15
Hong Kong	—	3	—	2	5
India	—	10	—	—	10
Israel	2	2	—	2	6
Pakistan	—	5	—	—	5
South Africa	2	4	—	—	6
Others	9	30	—	1	40
Total	155	252	20	63	490

In terms of numbers of banks, the United States is the most heavily represented country. But in terms of market share, the Japanese banks, with approaching a third of international liabilities, were by some distance the largest bank group at the end of 1985. British banks were some way behind, with 19% of the market, followed by the Americans with 16% and Continental European banks, taken together, with 12%.

The publication of new BIS statistics makes it possible to illustrate the importance of London in the international activities of various nationalities of banks (Table B).⁽²⁾ At end-September 1985, almost 40% of Japanese-owned banks' international business was booked by their London branches and subsidiaries. The scale of international business conducted by Japanese banks in London approaches that of all banks in Japan, and their eurobanking business is considerably greater. At end-September 1985, a quarter of the international liabilities of American-owned banks, displaced by the Japanese as the world's largest international banking group during the course of the year, were booked in London. At this date, the liabilities of American banks in London were three quarters of the size of the external liabilities of International Banking Facilities (IBFs) in the

(1) The BIS reporting area includes banks in the Group of Ten countries plus Austria, the Bahamas, Bahrain, the Cayman Islands, Denmark, Finland, Hong Kong, Ireland, Luxembourg, the Netherlands Antilles, Norway, Singapore and Spain and branches of US banks in Panama.

(2) *International banking developments, third quarter 1985, part II, 'The nationality structure of the international banking market'*. BIS, January 1986.

Table B
The importance of international business booked in the United Kingdom to various bank nationality groups

\$ billions; at end-September 1985

Parent country of bank	Total international liabilities booked in the BIS reporting area(a)	Of which, percentage booked in the United Kingdom
Austria	41.2	..
Belgium	45.2	4
Canada	97.2	36
Denmark	14.6	..
France	207.8	12
Germany, Federal Republic	142.8	25
Italy	94.3	20
Japan	621.5	38
Luxembourg	11.3	..
Netherlands	64.0	12
Spain	23.2	9
Sweden	24.5	..
Switzerland	88.4	26
United Kingdom	181.5	81
United States	545.6	25
Other BIS reporters	19.8	89
Sub-total	2,222.9	31
Consortium banks	39.1	53
Other developed countries	29.4	58
Eastern Europe	8.2	31
Latin America	13.1	40
Middle East	29.1	46
Others	41.5	53
Unallocated	2.7	67
Total	2,385.9	32

.. not available.

(a) Industrial reporting countries only.

United States, many of which are not US-owned.⁽¹⁾ The importance of London in the international business of European banks is generally less than that for banks with head offices outside Europe, but is nonetheless considerable, particularly for Swiss, German and Italian banks. In the case of foreign banks from countries outside the BIS reporting area, London is by a clear margin the centre of their international and eurobanking operations.

Business conducted between banks dominates the total international banking business conducted in London. At the end of 1985, interbank loans accounted for over three quarters of outstanding international claims, and interbank liabilities for a similar proportion of outstanding liabilities. The interbank market centred on London has three elements: transactions in foreign currency with other resident banks, which account for approximately a quarter of all interbank business; cross-border transactions with related offices, approaching two fifths of the total; and cross-border transactions with unrelated banks, which are of similar size to business with related offices. An outstanding structural characteristic of the international interbank business at the end of 1985 was the extent to which Japanese banks located in the United Kingdom borrowed from unrelated banks overseas and in London in order to lend to their own offices, mainly head offices in Japan.

Analysis of the 'pure' international interbank market in London (that is business between unrelated banks) on an

individual bank basis shows that, at end-1985, there were almost identical numbers of net lenders and net borrowers. Small numbers of large banks dominated net international lending to, and net international borrowing from, unrelated banks. Twelve banks of various nationalities, out of a total of 472 reporting international business, accounted for half of all net international interbank lending, and 37 for three quarters. The comparable numbers in the case of net borrowing were 14 (11 of which were Japanese) and 41 respectively. Conventional wisdom might have suggested that, because non-bank deposits are placed mainly with larger, well-known banks, there would be a relatively small number of large net suppliers of interbank funds, but a larger number of net takers on a smaller scale.

The conventional wisdom is at least correct in respect of the concentration of non-bank deposits with a relatively small number of large banks, although the concentration is only slightly greater than for all liabilities. At the end of 1985, just 10 banks held 28% of the \$138 billion of international deposits placed in London other than by banks and official monetary institutions, while half of the deposits were placed with just 30 banks.

Looked at broadly in terms of net sources and uses at the end of 1985, international banks in London borrow mainly from Switzerland, the United States and the Middle Eastern oil exporting countries, and lend to banks in Japan, residents of most European countries, and to countries outside the BIS reporting area, particularly to Latin America. This pattern, full detail of which is given in Table C, is very similar to that for all BIS-area banks.⁽²⁾ Switzerland is much the largest net depositor with UK banks, although it should be noted that the major source of supply is through Swiss banks' trustee or fiduciary accounts. Non-banks in the United States, the second

Table C
Net cross-border supply of funds to 'international' banks in the United Kingdom: end-December 1985

\$ billions; outstanding net supply (-)/use (+)

	Banks	Non-banks	Total
By residents of:			
BIS-area industrial countries	-17.1	-10.9	-28.0
of which			
Belgium	+ 0.6	+ 3.2	+ 3.8
Canada	+ 2.6	- 0.5	+ 2.1
Denmark	+ 1.1	+ 4.7	+ 5.8
France	+ 3.0	+ 4.6	+ 7.6
Germany, Federal Republic	- 3.5	+ 5.0	+ 1.5
Italy	+ 0.8	+ 8.8	+ 9.6
Japan	+33.8	+ 1.1	+34.8
Luxembourg	+ 3.6	+ 0.1	+ 3.7
Netherlands	- 4.8	- 1.2	- 6.0
Spain	- 5.3	+ 3.9	- 1.4
Sweden	+ 2.6	+ 3.0	+ 5.6
Switzerland	-57.2	- 8.1	-65.2
United States	+ 3.7	-43.9	-40.2
'Offshore' centres	+10.0	- 7.3	+ 2.6
Countries outside the BIS area	-22.9	+33.1	+10.2
of which, oil exporters	-26.9	- 4.4	-31.2
Total	-30.0	+14.9	-15.2

(1) Banks in the United States were permitted by the Federal Reserve Board to establish International Banking Facilities with effect from early December 1981. IBFs are allowed to conduct banking transactions with non-residents without being subject to most of the restrictions and requirements placed on their US-based parent institutions. Free from reserve requirements and exempt from the need for Federal Deposit Insurance Corporation cover, the IBFs operate in an environment broadly similar to that in eurobanking centres.

(2) See the March 1986 *Bulletin*, pages 64-7.

largest suppliers despite recent withdrawals of funds, are comfortably ahead of the oil exporters. Notably it is banks, including central banks, in the oil exporting countries which are the principal depositors. Banks in Japan are by far the largest net borrowers of funds, supplied largely from the interbank market by their own branches in London. Non-banks in Italy are the second largest net borrowers among countries inside the BIS reporting area.

London's position in the international banking market

Although London remains by some margin the world's largest international banking centre, its share of the international lending conducted by banks in the BIS reporting area fell from more than 29% at the end of 1975 to just under 24% ten years later (Table D). Some of the fall, which occurred while international business booked in London more than trebled, was simply the result of the expansion of the reporting area, and exchange rate movements also complicate assessment, but there was nonetheless an underlying reduction of about three percentage points in the United Kingdom's market share.⁽¹⁾

Table D
London's share of international bank lending by BIS-area banks

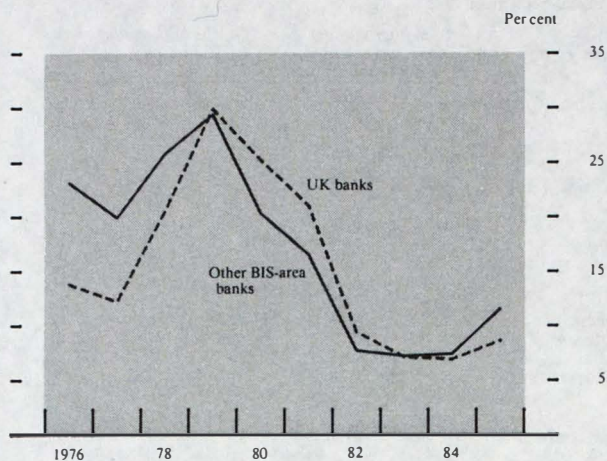
Percentages, at end-years

	Foreign currency lending to:		Domestic currency lending to non-residents (3)	External lending (2)+(3)	Total international lending (1)+(2)+(3)
	Residents (1)	Non-residents (2)			
1975	54.5	30.6	2.0	24.7	29.3
1976	51.6	28.7	1.5	22.9	26.9
1977	48.3	26.6	6.8	22.1	25.6
1978	45.2	26.4	6.4	21.8	24.7
1979	45.3	28.0	5.7	23.0	25.6
1980	45.1	28.9	6.7	23.8	26.4
1981	44.1	29.8	5.6	24.0	26.3
1982	44.7	30.8	4.8	23.6	26.2
1983	41.3	31.3	4.6	23.8	25.2
1984	36.7	29.3	4.6	22.9	24.3
1985	37.6	28.4	5.3	22.2	23.7

The largest drop in share unconnected with the enlargement of the reporting area occurred in 1976, when the business of banks in the 'offshore' centres, especially the branches of US banks, grew very rapidly. London's market share rose and then stabilised in the late seventies and early eighties as cross-border lending from London grew at between 20% and 30% each year (Chart 1). Since the general slowdown in international business following Mexico's moratorium on debt repayments in 1982, the UK share has fallen again.

The establishment of IBFs in the United States in December 1981 appeared to have no immediate effect on

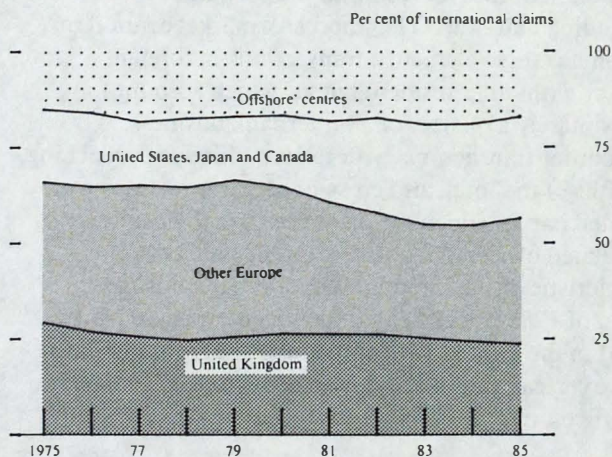
Chart 1
Growth of external liabilities^(a) of UK and other BIS-area banks



(a) Exchange rate adjusted flows.

international business conducted in London, although it is of course not possible to say how the London branches of American banks would have behaved had IBFs not been permitted by the Federal Reserve Board. The market share of banks located in the United States rose considerably in the first two years of the operation of the IBFs but the notable losers of share in the same period were the 'shell' branches of US banks in the Bahamas and Caymans, which shifted business to their newly-formed affiliates, rather than banks in the United Kingdom. However, the importance of all banks in the 'offshore' centres increased considerably during the decade as a whole, despite a considerable fall in 1985, with their share of eurocurrency business rising from 24% to 30%. There is no direct measure of the effect of their presence on London's growth. But it is observable that London's share of eurocurrency business fell very little in the period while that of the other European centres fell to a greater

Chart 2
Shares of international bank lending



(1) Austria, Denmark and Ireland joined the reporting area at end-1977, while Finland, Norway, Spain and the major 'offshore' banking centres began to report at end-1983. The combined effect of this expansion in the coverage of the BIS international banking statistics was to reduce the United Kingdom's contribution to the aggregates by around two percentage points. The aggregates are expressed in dollar terms and are thus influenced not only by actual changes in business but also by exchange rate movements of the dollar against the other principal currencies of transaction. In assessing the market share of banking centres, exchange rate movements would have no effect if the currency composition of business were uniform. But this is not the case, and the share of the centres with above-average dollar business (the United States, the 'offshore' centres and the United Kingdom) was raised by the strength of the dollar between 1982 and early 1985 and has since been lowered. The dollar's appreciation and depreciation had the opposite effect on the European centres with higher proportions of non-dollar business.

extent. A pronounced shift in the distribution of international banking business from Europe to locations in other time zones is apparent (see Chart 2), but the United Kingdom has maintained, and in the case of eurocurrency business increased, its share of business booked in Europe.

Examined in terms of the types of international business, London's falling overall share was largely attributable to relatively slow growth in domestic lending in foreign currency. Despite growing in the United Kingdom at an annual rate of 13%, principally reflecting interbank business, the pace of such lending was greater in most other centres, particularly in Japan.

Bank representation in London

In the ten years to the end of 1985, the number of banks reporting details of their international business to the Bank of England rose by just over 50%, from 310 to 472. The reporting populations as defined above are slightly smaller than the total populations of banks engaged in international business and represented in the United Kingdom,⁽¹⁾ but are reasonable indicators of total numbers and clearly the appropriate frame of reference for an article which concentrates on the statistics supplied by the institutions reporting to the Bank of England. Rapid though the growth in the reporting population between end-1975 and end-1985 was, it was slower than in the preceding decade, when numbers approximately trebled.

Changes in the reporting population are measures of net entry and can be broken down into gross components: new reporters, and banks leaving the market. One interesting feature of the components is that while there were almost 230 new reporters during the ten years, 65 banks ceased reporting.⁽²⁾ The number of banks leaving the reporting

population in the years 1981 to 1985 was twice as great as in the preceding five years, although there was no pronounced acceleration within the period. The largest bank genuinely to depart was Wells Fargo, which closed its London branch in June 1985 in order to concentrate more on domestic business, but most of those leaving the market were small.

Most foreign banks operating in London are branches of their overseas parents (Table A), and the numbers of such branches grew by more than a third in the ten years to the end of 1985. During the same period, representative offices almost doubled in number, perhaps illustrating the central importance of London in the international banking markets as clearly as the statistics of balance sheet size. Subsidiaries registered in the United Kingdom are the least favoured form of representation but displayed the greatest growth in the decade under review.

Size of individual bank operations and measures of market concentration

Between 1975 and 1985, while the reporting population expanded by slightly more than 50%, the international liabilities of reporting banks grew by over 300% in current dollar terms (Chart 3). After allowing for inflation, the real growth of liabilities in constant dollar terms was around 200%.⁽³⁾ The balance sheet of the 'average-sized' international bank in London thus grew by around 175% in current dollars over the decade, and by just under 90% in real terms.

However, the concept of the 'average-sized' bank may not be particularly helpful in a market displaying a relatively high degree of concentration. International banking business undertaken in London displays less concentration of ownership than many domestic banking systems, but the largest banks nonetheless hold sizable market shares and the operations of the majority of banks are on a correspondingly more modest scale. There is no doubt that, at both the beginning and the end of the decade under review, most of the international banking business booked in London was undertaken by a small number of large banks (Table E and Chart 4). But interpretation of

Chart 3
Growth of international banking in London

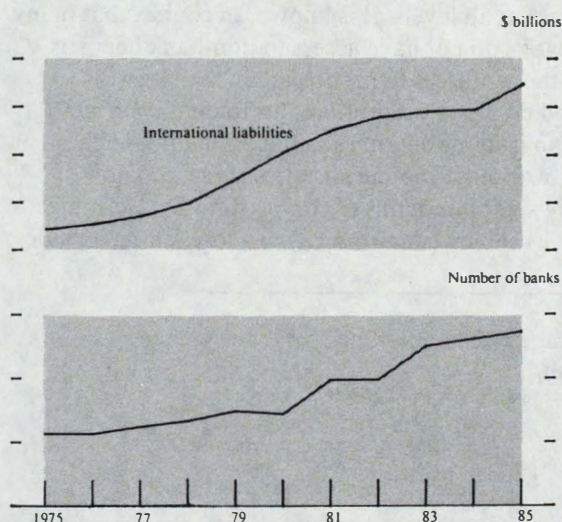


Table E
Concentration of international banking activity in London

Percentages of total international liabilities, at end-years

	1975	1980	1985
Largest 5 banks	20	17	15
Largest 10 banks	32	29	25
Largest 15 banks	41	37	34
Largest 20 banks	47	44	41
Largest 25 banks	53	50	47
Largest 50 banks	72	68	66
Largest 100 banks	89	86	83
Largest 200 banks	99	97	95
Numbers of reporting banks	310	344	472

(1) The reporting populations are smaller than numbers of banks represented in London because representative offices, which do not themselves book business, fall outside the scope of the statistical record.

(2) Departure from the reporting population is not synonymous with closure—because of mergers for example—but is a reasonable proxy for withdrawal from the market.

(3) The deflator used here is world trade prices. Questions relating to the deflation and scaling of international banking business are discussed in the December 1983 *Bulletin*, pages 557–65.

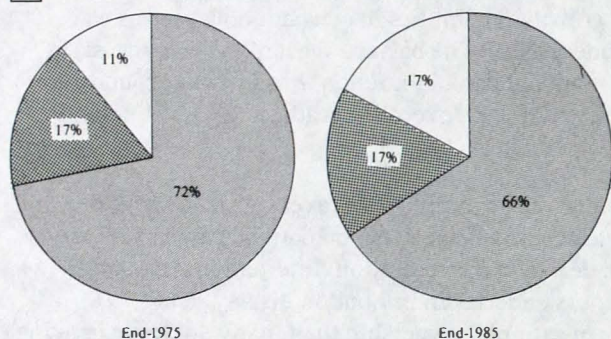
whether market concentration changed significantly over the period is rather more complicated.

The statistics showing the market share of specific numbers of banks suggest a moderate trend toward a more even distribution of international business. At end-1975 the largest 25 banks had over 50% of international liabilities, while the largest 50 accounted for over 70%. Ten years later, the comparable market shares had both fallen by six percentage points. This impression is confirmed by the relative growth in the average balance sheets of banks in the various size groupings: the smaller banks, those outside the largest 100, grew more rapidly than the larger banks over the period. This factor, together with the considerable expansion in the numbers of small banks which joined the reporting population, acted to reduce the market share of the larger banks.

Chart 4
Concentration of ownership of international liabilities in London

Percentage of total international liabilities

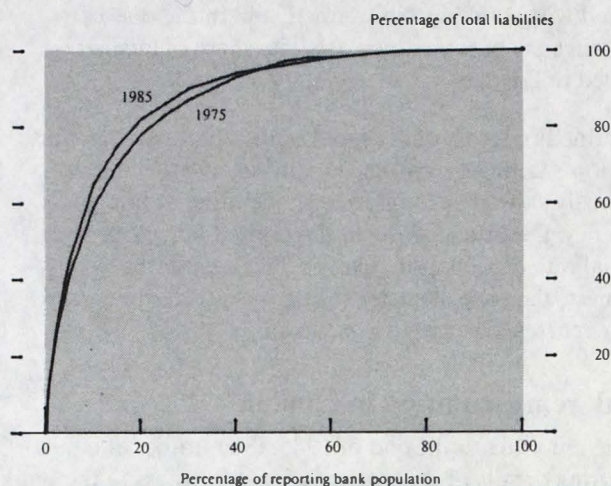
- Largest fifty banks
- Second largest fifty banks
- Other banks(a)



(a) End-1975: 210 in number; end-1985: 372.

Another way of assessing market concentration is to relate market share not to specific, fixed numbers of banks (for example the largest 25) but to numbers of banks expressed as proportions of the reporting population (for example the largest 25%) of reporters. In contrast to the fixed numbers measure, this approach suggests that the market domination of the larger banks increased slightly during the decade. Thus the concentration curve moves slightly upwards over time in Chart 5. While the second method of assessing concentration may be preferable because it relates the larger banks explicitly to the growing numbers of reporting banks, the reliability of both methods as a guide to movements in concentration over the period depends upon the nature of the rise in reporters. The expansion in the number of banks reporting details of their international business was in fact partly the result of wider statistical coverage rather than genuine new entry into the international banking community in the United Kingdom. The implication is that the fall in market share of the larger banks shown in Table E was more apparent than real, because the shares at end-1975 and end-1980 were exaggerated, and that the upward shift in the

Chart 5
The concentration of international liabilities among banks in the United Kingdom



concentration curve in Chart 5 was also principally the result of changes in statistical coverage. On balance, therefore, there was probably little change in the concentration of ownership of banks' international liabilities in London during the ten years.

There was considerable movement in size rankings among the larger banks within the period, with the second and third tiers of 'large' banks, those in the top fifty but outside the top ten, growing more rapidly than the first tier, and the composition of the latter also changing markedly (Table F). Exchange rate movements explain some but far from all of the changes in rankings. The rapid growth of Japanese banks and the largely managed balance sheet slowdown of the Americans—developments discussed more fully later—offer the principal explanation. Another notable feature of the statistics is the wide divergence in size between bank groups. The size differences are large enough to suggest that the smaller banks may not compete actively with the larger banks at all levels. It is known, of course, that many smaller banks do not have access to non-bank deposits and lack the resources to participate in the larger syndicated credits. Furthermore, for many the prime motivation is home country lending. It is impossible, however, working from the statistics alone, to know where any size boundaries of competition lie. Defining small banks somewhat arbitrarily as those falling outside

Table F
The average size of 'international' banks in London

\$ millions, at end-years; percentage growth in italics

Size ranking of bank at each date	Average size of international liabilities			Growth of international liabilities 1976-85
	1975	1980	1985	
1-10	5,991	14,727	20,020	+234
11-25	2,637	7,115	11,546	+338
26-50	1,432	3,695	6,101	+326
51-100	637	1,909	2,653	+316
101-200	187	580	929	+397
201+(a)	24	93	158	+558

(a) 110 banks at end-1975; 144 at end-1980; 272 at end-1985.

Table G
Shares of international business of bank nationality groups in London

Percentages of total international liabilities, at end-years

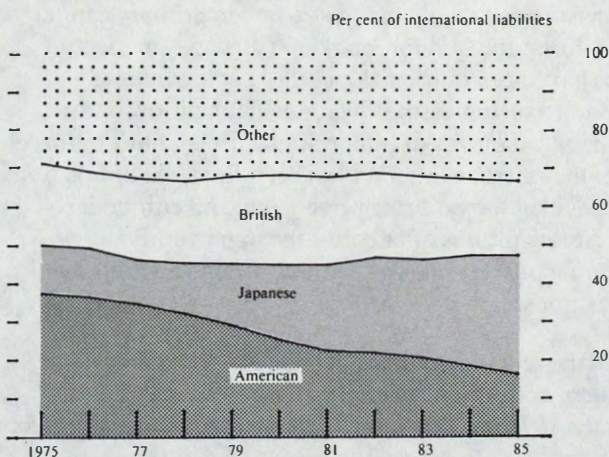
	Nationality of bank ownership					Consortium
	American	British	Japanese	Other overseas		
				Total	of which, EC countries	
1975	38	21	13	23	6	6
1976	37	20	13	25	8	6
1977	35	21	12	27	9	6
1978	32	21	13	28	10	6
1979	29	23	16	27	11	5
1980	25	23	20	27	10	5
1981	22	23	23	29	10	4
1982	22	22	25	28	10	4
1983	21	22	26	29	11	3
1984	18	20	29	30	12	3
1985	16	19	31	31	12	3

the largest 100 reporters, it is observable that the bottom tier, comprising banks outside the largest 200, grew more rapidly than the middle tier, perhaps suggesting greater competition among the smaller banks during the period.

Business of bank nationality groups

The other principal aspect of market structure and growth is the bank nationality dimension (Table G and Charts 6 and 7). An outstanding feature of the decade was the growth of Japanese banks in London, particularly since the end of 1978. They accounted for more than a third of the total growth in UK banks' international liabilities in the ten years under review, raising their market share from 13% to 31%. In terms of the bank size groupings discussed earlier, Japanese banks' representation in the largest twenty-five group increased from five at end-1975 to twelve ten years later. The increased representation in the largest ten group was even more pronounced, rising from one to six in the decade.⁽¹⁾ As the most rapidly growing banks during the period, the Japanese clearly presented strong competition to other large banks operating in London. At the same time, it would seem reasonable to conclude that, as things now stand, the principal competitors of large Japanese banks in London are, in

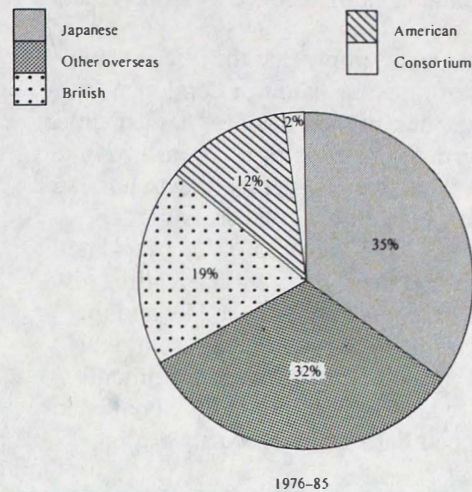
Chart 6
International market shares of major bank groups in London



(1) Japanese banks made similar progress in world league tables of bank size. In 1979, Dai-ichi Kangyo was the only Japanese bank represented in the top ten list compiled by *The Banker*. In 1985, five Japanese banks, Dai-ichi, Fuji, Sumitomo, Mitsubishi and Sanwa, were listed.

Chart 7
Bank group contribution to growth of international liabilities in London

Percentage of total liabilities



many cases, other large Japanese banks. They are competitors, for example, in bidding for interbank deposits, and in participating in new loans.

All thirteen Japanese City banks now have branches in London, as do the three Long Term Credit banks, six out of the seven Trust banks (the seventh has a representative office) and the largest Regional bank. Nine of the twenty-five Japanese banks in London reporting international liabilities at end-1985 entered the reporting population after 1975, but only one of those ranks among the larger banks in London, and together the newcomers accounted for only one eighth of the rise in Japanese banks' business during the decade.

The scale of Japanese banks' activities changed rather more than their form in the ten years under review. Throughout the period, the major business of Japanese banks in London was the supply of funds to their own offices overseas, principally to head offices in Tokyo. After allowing for inflation, the net outstanding lending to own offices fell between 1975 and 1978, a period in which Japan's current account adjusted to the oil price rises earlier in the decade. It then rose sharply in 1979 and 1980, when oil prices increased rapidly again. A reduction in the early eighties was followed by very large growth in net lending to own offices in 1984 and 1985. During the years of unprecedented current account surplus, Japanese banks, in part because of cheaper dollar funds in London than in Tokyo, have increased their net borrowing from the London-based eurobanking market. The easing of restrictions on Japanese banks' foreign currency operations also appears to have stimulated the flow of funds to Tokyo. It is impossible to trace the use of the borrowed funds with precision, but it is notable that foreign currency lending to residents by banks in Japan has grown contemporaneously with the sharply higher net borrowing from London. At the same time, non-banks

in Japan have been major purchasers of international, particularly American, securities, financing at least some of the purchases by borrowing. There has also been strong growth in international lending booked by banks in Japan.

This should not, however, imply that the international banking activities of Japanese banks in London are narrow. In fact, the range of their business has expanded considerably. In terms of broadening relationships in the interbank market, their cross-border lending to unrelated banks rose from less than 30% of total cross-border interbank loans at end-1975 to over 50% ten years later. During the same period their international lending to non-banks rose at an annual rate of over 25% and they played a prominent role in 'securitised' international lending. Japanese banks' underwriting commitments under note issuance facilities are also mainly booked in London, through their banking and security dealing subsidiaries.

American banks' involvement in the international banking markets in London is in many ways the mirror image of the Japanese banks' position. Although American banks' international balance sheets expanded in the decade as a whole, rising by an average of 6% each year, their market share fell steadily. At the end of 1975 they were the largest bank group involved in international banking in the United Kingdom, and, as the longest-established foreign bank group, had international liabilities only slightly smaller than those of all other non-British banks in aggregate. In the next ten years their market share fell from 38% to 16%. As a group they were overtaken in balance sheet size by the British and Japanese in 1981. In terms of the size ranking of individual banks, the relative contraction of American banks' activities is illustrated by their falling presence among the largest banks—a decline from five of the largest ten banks at the end of 1975 to one ten years later. Regional banks as well as the money centre banks are represented in London, although several of the former and one of the latter have closed their London operations in the recent past as part of their policy of concentrating on domestic business and reducing international exposure. Despite some notable withdrawals from the London market during the decade, the reporting population expanded

slightly. But the new entrants accounted for only 6% of the growth in international liabilities in the period.

The statistical record alone is not sufficient to provide reasons for the falling market share of American banks, although it does show that the falling share was the result of a general slowdown in growth rather than a slowdown specific to a few banks. There is some evidence that part of the reduction may have been the result of the transfer of business from London to branches in the Caribbean in the seventies and to IBFs in the eighties.⁽¹⁾ In the second half of the seventies, lending by American banks in the offshore centres grew almost twice as rapidly as their lending out of London, while the IBFs' share of all international lending undertaken by BIS-area banks rose from 2.8% at end-1981 to 6.3% four years later.

A very considerable reduction in business with unrelated banks—the 'pure' interbank market—lies behind much of the decline in American banks' relative size since 1981 (Table H). In the four years to the end of 1985, lending to unrelated banks overseas fell at an annual rate of 1.3%, while lending to other banks in the United Kingdom also contracted sharply. During the same period, lending to own offices abroad and international lending to non-banks continued to grow. However, the pattern of net lending to own offices did not entirely follow the Japanese banks' pattern. American banks in London steadily increased their net lending to own offices until the end of 1983, at which time they were net suppliers of over \$38 billion, but have since greatly reduced their net claims (although the proportion of gross claims fell only slightly). A Federal Reserve study⁽²⁾ showed that in 1984 the cost of funds for overseas branches was considerably higher than for head offices, and, in the era of global treasury management, cost considerations seem to have been the principal reason for the reduction in 'offshore' funding.

Part of the reduction in business with unrelated banks may be the result of the continued funding of IBFs, but more generally the experience of American banks has reflected their successful response to internal pressure from management to improve performance as measured by return on assets, and to external pressure from bank supervisors and regulators to strengthen primary capital ratios. From the London market evidence, American banks have been quicker than other bank groups to respond to such pressures by reducing their low return interbank business. An important factor enabling reduced use of the interbank market has been financial innovation. In particular, forward rate agreements and eurodollar interest rate futures offer banks the opportunity of managing interest rate risk without recourse to interbank transactions.

While the relative volumes of business booked by Japanese and American banks changed so markedly between 1975 and 1985, the market share of British banks

Table H
American banks in London: composition of international lending

Percentages of outstanding international claims, at end-years

	Claims on own offices overseas	Claims on unrelated banks	Claims on non-banks and CMIs
1975	28	50	22
1976	28	51	21
1977	30	47	23
1978	33	41	26
1979	37	43	20
1980	32	45	23
1981	34	39	27
1982	41	33	26
1983	45	29	26
1984	44	27	29
1985	44	26	30

(1) The shifting of business from foreign branches, particularly those in the Bahamas and the Caymans, played an important part in the initial funding of American-owned IBFs (*Federal Reserve Bulletin*, October 1982, pages 565-77).

(2) *Federal Reserve Bulletin*, November 1985, pages 836-49.

remained broadly stable, at around 20%. The composition of their business is understandably rather different from that of the foreign bank groups represented in the United Kingdom, with cross-border sterling business and trade-related loans backed by the Export Credit Guarantee Department being considerably more important. The geographical distribution of British banks' business also differs from that of the other banks, influenced by long-standing trade-related and traditional banking relationships and the absence from the figures of the home country lending which is so prominent in the case of many foreign banks.

Although British banks remain the largest group involved in cross-border transactions in sterling, participation in this business became much more evenly spread between all bank groups during the ten years to 1985, and particularly so since the ending of exchange controls in 1979. At the end of 1975, British banks held three quarters of all non-resident sterling deposits, while ten years later they held less than half. British banks of course have access to retail deposits which are likely at various times to be cheaper than the largely wholesale, non-resident deposits. However, the demand from American, Japanese and other overseas banks for external sterling deposits clearly rose in the years 1976-85, and competition between banks to attract the deposits is likely to have been greater than previously. The foreign banks remained considerably more reliant than British banks on external interbank sterling deposits, in which transactions with own offices, especially in the case of the Japanese branches, played an important part. British banks continue to hold the bulk of overseas non-banks' sterling deposits, including official holdings of sterling.

The picture on claims is similar. British banks' share of total external sterling lending fell considerably in the period, largely because of the sharply rising interbank business of foreign banks. But British banks' share of lending to countries outside the BIS reporting area fell by much less than the corresponding share of lending within the area, which is dominated by interbank transactions between London and the major eurosterling centres of France, Belgium and Luxembourg.

The geographical distribution of British banks' total cross-border business, and its departure from that of all banks in the United Kingdom, reflects the factors outlined above. Since 1982 their business has, following the general pattern, increasingly been conducted with residents of other industrial countries and the 'offshore' banking centres. But, because of the generally lower proportion of cross-border interbank business, in foreign currency as well as sterling, on the books of British banks, the proportion of their business conducted within the BIS area has remained consistently below that of all banks in the United Kingdom. Conversely of course, British banks have a higher proportion of business with countries

outside the reporting area, and particularly with the developing countries, than foreign banks operating in London.

Sources and uses of eurocurrency funds

From their inception, the eurobanking markets located in London performed the intermediary functions associated with domestic banking markets, but on an international plane. The size of transactions, individually and collectively, quickly surpassed those of most domestic markets. Eastern European countries, often identified as the first depositors, and US corporate borrowers, who turned to the euromarkets as a source of funds when domestic credit controls were introduced, are the best known early users of the markets. Throughout most of the seventies and early eighties an outstanding feature of the eurobanking markets was their role in financing world payments imbalances, the so-called 'recycling' process.

The oil exporting countries, whose export earnings rose so dramatically with the quadrupling of crude oil prices in 1973-74, initially held most of their rapidly accumulating foreign assets in the form of foreign currency bank deposits, and their portfolio diversified only slowly over time.⁽¹⁾ Eurocurrency deposits in London were the single most important component of liquid assets purchased after the first oil 'shock', and London was an even more favoured location for the new deposits acquired as a result of the second round of price increases in 1979 and 1980. The current value of the oil exporters' international, mainly eurocurrency, deposits with banks in the United Kingdom rose by \$21 billion, growth of 70%, from 1974 to 1978, and then more than doubled, increasing by over \$40 billion, between 1979 and 1981. During these years liabilities to the oil exporters, and particularly to the Middle Eastern members of OPEC, accounted for a very significant proportion, between 14% and 17½%, of the total external liabilities of banks in the United Kingdom. However, these figures do not convey the full importance of the oil exporters as a source of funds for the London market. In terms of net supply by broad geographical groups, the oil exporters were essentially the only source at end-1977, at which date BIS-area countries and 'offshore' banking centres in aggregate were net takers, and at end-1981 they were responsible for nine tenths of net supply. Even at the end of 1985, when liabilities to the oil exporters represented only 8½% of total external liabilities compared with the peak contribution of 17½% eight years earlier, they were more important net suppliers than the BIS-area countries taken together.

Looked at again in broad net terms, borrowings from the oil exporters between 1977 and 1981 were used by banks in the United Kingdom to finance lending to countries outside the BIS reporting area, and principally to non-oil developing countries in Latin America. In gross terms, new deposits from the oil exporters were of more or less

(1) See 'Oil exporters' surpluses and their deployment' in the March 1985 *Bulletin*, pages 69-74.

the same size as new lending to the larger Latin American countries.

At the end of the period under review, banks in London held one fifth of all BIS-area banks' claims on countries outside the reporting area. Within that aggregate, lending out of London to non-oil developing countries in Asia accounted for only 13% of the BIS-area banks' total, while at the other extreme one third of all lending to developed countries located outside the BIS area was booked in London. The range of contributions to BIS-area banks' total lending, at geographical group and individual country level, is explicable in terms of the traditional lending patterns of British banks, and the division of international banking responsibilities between foreign banks in London and their head offices and affiliates. The high proportion of claims on Nigeria, for example, is explained by British banks' traditional links with a major trading partner. The same explanation applies in the case of lending to Australia, New Zealand and South Africa. A rather different reason accounts for the above average lending to Eastern Europe. Banks in the United States, and American-owned banks worldwide, lend relatively little to Eastern bloc countries and the proportion of total BIS-area banks' claims on those countries booked in other centres, and by other bank nationalities, is accordingly raised. France and West Germany are also important centres of lending to Eastern Europe. Conversely, American banks' contribution to lending to Latin America is high and, as the lending is mainly on the books of head offices in the United States, claims on the area booked by banks in London represent under 17% of the BIS-area banks' total, compared with their 20% contribution to all outside-area lending. In the case of lending to Asian countries, banks in Japan and the Asian 'offshore' centres dominate the market, and London's contribution at end-1985 was only 13%.

The slowdown since 1982 in UK banks' lending to developing countries has closely followed that of all BIS-area banks. Net lending, however, has still mainly been to countries outside the BIS area, dominated by flows of new money provided to Latin American countries as part of rescheduling packages.

Securitisation of international lending

A major feature of international banking flows since the first debt crisis broke in 1982 has been the renewed securitisation of international financial flows. Banks have been active on several fronts of this development, as managers, underwriters, issuers and as purchasers of securities—both fixed-rate and floating-rate notes (FRNs). Their desire to hold more marketable and liquid assets has been prompted by the deterioration in the quality and liquidity of their portfolios, resulting from the debt problems of many developing countries, and by prudential concerns. UK banks' holdings of FRNs have more than

trebled since the statistics were first collected at the end of 1983, and their demand has been a major reason for the continued growth of the market. Indeed, the buoyancy of the market will have been a factor encouraging banks also to issue such securities as a competitive source of longer-term funding. In 1985 their holdings of FRNs grew by \$12½ billion, slightly over a third of all new issues, net of repayments, made during the year. Japanese banks' holdings are larger than those of all other nationality groups taken together.

Holdings of other securities (including fixed-rate bonds but excluding equities) were about one half of the value of FRN holdings at end-1985. In total, securitised lending accounted for one eighth of cross-border lending, other than to affiliates, at that date. In the case of Japanese banks in London the proportion was one sixth. The holdings of UK banks fully reflect the dominance of industrial country borrowers, and issues of developing countries represented under 5% of UK banks' holdings, by value, at the end of 1985.⁽¹⁾

The interbank market

The interbank market consistently formed the largest part of all international banking business conducted in London between end-1975 and end-1985. The market performs a vital function, directly or indirectly enabling surplus funds to be bought by banks which have identified non-bank borrowers, and also providing banks with the means of meeting temporary liquidity shortages and hedging interest rate risks.

The ratio of the stock of international interbank lending to all international lending by banks in London was very stable in the ten years under examination (Table J). A BIS study⁽²⁾ found that the same was true of the external interbank lending of all BIS-area banks between 1975 and 1981. But in the shorter term, there was no such predictable relationship between quarterly changes in interbank and total international lending by banks in London from 1975 to 1985, with the importance of

Table J
Interbank claims

\$ billions, at end-years; figures in italics are percentages

	Outstanding claims		Changes in claims (a)	
	International interbank claims	<i>As percentage of total changes in international claims</i>	International interbank claims	<i>As percentage of total changes in international claims</i>
1975	129.9	70
1976	147.4	71	17.8	77
1977	165.9	69	18.2	58
1978	209.4	70	43.5	74
1979	286.1	73	76.7	84
1980	365.2	74	79.1	78
1981	425.8	73	60.6	68
1982	454.6	73	28.8	64
1983	461.3	72	6.7	45
1984	460.9	72	- 0.4	-18
1985	554.0	72	93.1	73

.. not available.

(a) Not adjusted to exclude exchange rate effects.

(1) For further detail, see the March 1986 *Bulletin*, pages 43-4.

(2) *The international interbank market: a descriptive study*. BIS Economic Papers no 8, 1983.

interbank flows sometimes well above and sometimes well below the stock ratios. Within each year there were large swings in the importance of interbank lending, primarily associated with the 'window-dressing' or balance sheet expansion activities of foreign banks in London. For example, the business of Japanese banks tends to expand most rapidly in the first and third quarters of each year, before the end and mid-point respectively of the Japanese financial year; and Continental European banks typically expand their books in the final quarter of each calendar year.

Despite the stable relationship between the stocks of interbank and total claims, changes are discernible in the composition of interbank business. American banks' reduced reliance on the interbank market as a means of managing interest rate risk has already been discussed. In other respects, however, the dependence of banks in London on the 'pure' interbank market would seem to be growing. Table K shows the importance of deposits from unrelated banks at end-1975, end-1980 and end-1985. After falling between the first two dates, the ratio of deposits from unrelated banks to total deposit liabilities rose sharply between 1980 and 1985. Most of the new reporting banks in the first half of the eighties, being relatively small, would be expected to rely on interbank

Table K
Dependence on deposits from unrelated banks

Numbers of banks, at end-years; percentages of reporting banks in italics

Deposits from unrelated banks as percentage of total international deposit liabilities	1975		1980		1985(a)			
					(1)		(2)	
Over 90	16	5	7	2	45	10	22	6
Over 80	23	7	14	4	91	19	48	14
Over 70	38	12	25	7	129	27	73	21
Over 60	53	17	42	12	170	36	109	31
Over 50	69	22	63	18	226	48	150	42
Over 40	95	31	90	26	260	55	178	50
Over 30	120	39	124	36	300	64	210	59
Over 20	159	51	154	45	329	70	233	66
Over 10	186	60	196	57	363	77	256	72
Over 5	199	64	223	65	374	79	265	74
Over 0	204	66	237	69	401	85	284	80

(a) Column (2) excludes those banks reporting international business in 1985 but not in 1980.

borrowing and thus raise the dependence ratio somewhat artificially. But after excluding those banks the ratio still rose sharply. The statistics illustrate the central role of the interbank market, the interdependence which it creates, and the potential implications of disturbances which adversely affect interbank relations and perceptions of risk.

The currency and maturity composition of foreign currency business

Information about the currency composition of lending by banks in the United Kingdom became available, on a consistent basis, only in 1978. The stock data show little change in the currency composition of lending by banks in the United Kingdom (Table L) in the seven years to end-1985. The share of the dollar, easily the most

Table L
Currency shares of foreign currency lending^(a) by banks in London

Percentages of outstanding claims, at end-years

	US\$	DM	Sw. Fcs	Yen	Other
1978	76	12	5	2	5
1979	78	12	5	2	3
1980	78	10	5	2	5
1981	78	9	5	3	5
1982	79	8	5	3	5
1983	80	8	5	3	4
1984	80	8	4	4	4
1985	72	10	6	7	5

(a) Lending in ECU is broken down into the currencies of composition.

important currency throughout, rose gently until 1983 before falling sharply in 1985, while the deutschemark's share followed an opposite pattern, falling steadily until 1984 but recovering much of the lost ground in 1985. Lending in Swiss francs and other currencies less widely used in international banking business accounted for approximately one tenth of total outstanding loans throughout the period. The yen, on the other hand, steadily increased in importance.

The currency preferences of borrowing countries varied quite considerably, although the dominance of outstanding dollar-denominated loans was a constant theme. The scale of countries' diversification away from dollar borrowing runs from the Eastern bloc, with 40% of non-dollar denominated loans at end-December 1985, to the Latin American countries, with only 8%. The importance of Swiss franc borrowing by Eastern European countries, particularly East Germany, is notable.

Maturity transformation, the financing of medium and long-term assets by short-term liabilities, is a feature of all banking activity. The importance of the interbank market in London has inflated the proportion of short-term international liabilities and assets. Nevertheless, short-term liabilities consistently exceeded short-term assets during the period under review. The extent of maturity transformation, measured by the mismatches between maturing liabilities and assets, widened between 1975 and 1985 in the shorter maturity bands up to three months, particularly in the second half of the period, but narrowed in the longer maturities. Aggregate analysis can perhaps not be carried much further. Maturity transformation varies between bank groups and between individual banks within groups, reflecting the particular types of business conducted. Some large banks now manage maturity transformation, liquidity and interest-rate risk on a global basis. The result of the trend towards global management, made possible by rapid technological advance, has been to make data on maturity transformation in any one location less meaningful. A greater maturity mismatch will generally involve higher interest rate risk and exposure to possible liquidity problems, but also, given a positive yield curve, the prospect of greater profits. Of course, balance sheet positions may be hedged in a number of ways and are not necessarily an accurate measure of exposure to risk.

Future developments

Despite rising competition in international banking and finance, London's historical advantages remain and seem likely to continue to support a leading role. Advances in communications technology give the euromarkets greater freedom to locate where they choose, but a pool of skilled and experienced manpower is a powerful attraction, and in this respect established, large financial centres enjoy a considerable advantage over newcomers.

Although Japanese banks are in international balance sheet terms now the largest group operating in London, and have led the way in securitised lending, American banks appear still to be market leaders in terms of innovation. Their present behaviour may accordingly be something of a guide to overall future developments. If this is the case, balance sheet growth may slow considerably as others follow the American lead in reducing use of the interbank market as a means of hedging interest and exchange rate risk. It seems likely that the other recent developments in the international

markets observable in London will also continue to be major features for some years. The reasons behind the securitisation of international lending—which include banks' perceived need for greater liquidity, their moves to generate income without expanding balance sheets, the deregulation of capital markets, and the preferences of investors for securities rather than bank deposits—seem sure to remain for some time.

On the statistical front, the challenge of the late eighties is to capture the growing off balance sheet dimensions of international banking in as complete and meaningful a way as possible. Just as the debt crisis brought demands for more comprehensive and timely data on banks' exposure to developing countries, so the rapid changes in international banking in the wake of the crisis have emphasised the need to measure the new directions of banks' business. To this end, the Bank and other monetary authorities are currently following up the statistical recommendations of the recent BIS Study Group.⁽¹⁾

(1) *Recent innovations in international banking*. BIS, April 1986. The findings of the study are summarised on pages 209–10 of the June 1986 Bulletin.