International financial developments

The main points in the latest period are:

- *The combined current account deficit of the major seven OECD countries widened further in the fourth quarter of 1985; but for the year as a whole the deficit was $10 billion less than in 1984, with a further increase in the US deficit more than offset by increases in the German and Japanese surpluses.*

- *The current account position of the non-oil developing countries deteriorated steadily throughout the year and the deficit for 1985 as a whole was more than double the total for the previous year.*

- *There was a continuing high level of activity in the fixed-rate bond market in the three months to February, but issues of floating-rate notes declined owing to unfavourable market conditions: announced syndicated credits, after declining steadily throughout 1985, recovered in January and February to the highest level for over a year.*

- *In the foreign exchange markets, the re-adjustment of the major currencies initiated by the G5 meeting in September continued, with the dollar falling back by a further 11% against the deutschemark and 10½% against the yen in the three months to end-February. Sterling was adversely affected by the sharp fall in oil prices, and fell by 10% in effective terms over the period.*

Balance of payments positions

The combined current account deficit of the *major seven economies* appears to have increased in the fourth quarter of 1985. Renewed strengthening of the Japanese current account was more than offset by another increase in the US deficit; the turnaround in US competitiveness that occurred in the course of 1985 has not, as yet, had much impact on their trade account. The current account surpluses of Germany and the United Kingdom both increased slightly.

For 1985 as a whole, the major seven economies' combined current account deficit fell by some $10 billion from its 1984 level but the imbalances between individual countries increased. While the US deficit deteriorated by a further $11 billion to reach $118 billion, the combined German and Japanese surpluses increased by $21 billion to a total of $62 billion. Improving Japanese competitiveness up to the early months of 1985 helped to restrain import volume growth to almost zero notwithstanding domestic demand growth of over 3%.

The combined current account deficit of the *smaller OECD countries* declined slightly in the last quarter of 1985, having been fairly stable throughout the year. For 1985 as a whole their current account deficit almost doubled compared with 1984, to $17 billion. This increase was spread amongst several countries: the Belgian surplus, by contrast, increased by some $3 billion, and the Netherlands, Norway and Switzerland remained in sizable surplus.

World current accounts[a]

$ billions; *seasonally adjusted*

	1984	1985(b)				
	Year	Year	Q1	Q2	Q3(b)	Q4(b)
OECD economies:						
Canada	2	- 1	—	—	- 1	- 1
France	—	- 1	- 1	—	—	—
Germany	6	14	2	3	4	5
Italy	- 3	- 3	- 2	- 3	2	—
Japan	35	48	9	12	12	15
United Kingdom	1	5	- 1	2	1	1
United States	-107	-118	-24	-28	-30	-36
Major economies	- 66	- 56	-17	-14	-12	-17
Other OECD	- 9	- 17	- 4	- 5	- 5	- 4
Total OECD	- 75	- 73	-21	-19	-17	-20
Oil exporting economies	- 9	- 3	—	—	- 1	- 2
Other developing economies	- 11	- 26	- 4	- 6	- 7	- 9
Other economies(c)	6	7	2	2	2	2
World discrepancy(d)	- 89	- 95	-23	-23	-23	-29

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

The current account of the *oil exporting countries* deteriorated in the third quarter of 1985 and the deficit is thought to have widened further in the fourth quarter; nonetheless, for 1985 as a whole, measures to restrict imports helped to produce a decline in the current account deficit from $9 billion in 1984 to an estimated $3 billion last year.

The current account of the *other developing economies* is thought to have weakened steadily during 1985, giving a deficit for 1985 as a whole of $26 billion, more than double the 1984 total. A major part of this deterioration can be

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

	1983	1984		1985(b)		
	Year	Year	Q4	Q1	Q2	Q3
Current account	**-29**	**-11**	**-3**	**- 4**	**-6**	**-7**
Capital account	**31**	**22**	**5**	**- 4**	**6**	**7**
of which:						
Concessionary and other official flows	24	26	6	6	6	7
Direct investment	9	8	2	2	2	2
Borrowing from banks(c)	12	10	4	- 2	3	4
Borrowing via bond issues	2	1	1	1	2	1
Other capital flows(d)	-16	-24	-8	-11	-8	-7
Official financing balance	**- 2**	**-11**	**-2**	**8**	**—**	**—**
of which:						
Use of IMF credit	10	5	1	—	—	1
Liabilities to other CMIs	- 3	1	—	—	—	—
Reserves etc (increase-)	- 9	-16	-3	8	—	—

(a) The definition of 'Developing countries' has been revised, to include China, Taiwan and Yugoslavia, since the December 1985 *Bulletin*.
(b) Includes Bank estimates.
(c) Adjustment to exclude valuation effects.
(d) Including net errors and omissions.

traced to China, where a surplus of $2.5 billion turned to sizable deficit as the Chinese growth rate increased sharply, leading to an increase of a third in imports. Elsewhere among the developing countries, many current accounts remained broadly unchanged; adjustment programmes continued to subdue imports, lower export market expansion and weakening commodity prices led to only muted increases in exports, while lower US interest rates eased interest payments on outstanding debt. Among the *other economies*, the depreciation of the rand helped to strengthen the South African trade and current accounts.

Capital inflows to the *other developing economies* continued to pick up in the third quarter of 1985 from the low point seen in the first quarter. In particular, net borrowing from banks amounted to $4 billion in the third quarter, compared with net repayments of $2 billion in the first. As usual, most spontaneous bank lending and a substantial part of the money raised from bond issues went to a small number of Asian borrowers. Outflows of other capital are thought to have eased again.

As their combined current account deteriorated during 1985, the *oil exporting countries* drew on their investments, identified assets of these countries falling by $3.0 billion in the second quarter and $4.3 billion in the third. Withdrawals from longer-term investments in the industrial countries (down $4.4 billion) and from UK and US government paper (down $2.3 billion) were the main areas of disinvestment during the third quarter. Bank deposits rose modestly (by $1.7 billion), although within this total deposits placed in the United Kingdom fell. Nevertheless, in dollar terms the value of the overall stock of deployed assets shows an increase of $3.4 billion over the twelve-month period to end-September 1985—the result of asset revaluations reflecting the decline in the dollar's international value, which has enhanced non-dollar assets, and the buoyancy of securities markets worldwide. Taken over the same period, the level of oil exporters' net external borrowing has remained little changed, despite a reduction of $1.3 billion in the third quarter. Provisional figures for deployment of funds in the United Kingdom and the United States in the fourth quarter suggest a modest rise ($0.7 billion) in bank deposits, offset by a reduction of $0.6 billion in non-banking assets.

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

	Sept. 1984 levels	1984	1985			Sept. 1985 levels	1985
		Q4	Q1	Q2	Q3		Q4(b)
Industrial countries							
United Kingdom:							
Sterling bank deposits	4.9	0.1	—	0.1	0.1	5.8	0.4
Eurocurrency bank deposits	44.3	-3.0	-0.1	2.4	-1.2	43.1	0.1
Government paper	2.6	-0.2	-0.1	0.3	-0.1	2.9	0.2
Other investments	5.5	—	-0.1	0.1	-0.1	6.5	-0.2
	57.3	-3.1	-0.3	2.9	-1.3	58.3	0.5
Other EEC:(c)							
Domestic currency bank deposits	3.7	—	-0.3	0.3	—	4.1	
Eurocurrency bank deposits	20.0	0.5	1.1	-0.4	0.1	21.8	..
Other investments	31.0	-0.1	0.5	-0.1	-0.3	36.0	..
	54.7	0.4	1.3	-0.2	-0.2	61.9	..
United States:							
Bank deposits	19.6	1.6	-0.1	-0.8	1.2	21.6	0.2
Government paper	30.7	0.5	0.2	0.1	-2.2	29.4	—
Other investments	31.3	-0.2	-0.5	-1.3	-0.8	28.3	-0.6
	81.6	1.9	-0.4	-2.0	-1.8	79.3	-0.4
Other:							
Domestic currency bank deposits	3.8	-0.4	-0.5	0.1	0.4	3.9	..
Eurocurrency bank deposits	26.7	0.3	0.5	1.3	0.3	29.2	..
Other investments	39.3	0.9	-1.5	-0.3	-3.2(b)	37.5	..
	69.8	0.8	-1.5	1.1	-2.5	70.6	..
Offshore centres:							
Bank deposits	41.7	0.6	0.2	-4.8	0.8	38.6	..
Placements with ldcs	59.0	0.4	-0.1	-0.6	—	58.8	..
OEC credit to non-banks	7.5	0.1	0.1	0.5	—	8.2	..
IMF and IBRD(d)	35.0	-1.1	0.4	0.1	0.7	34.3	0.2
Total identified additions(+)/reductions (-) in deployed assets	**406.6**	**—**	**-0.3**	**-3.0**	**-4.3**	**410.0**	..
Net funds available for deployment		1.2	-0.7	-0.5	-3.3		
of which:							
Net movements in external borrowing etc		*1.3*	*-0.5*	*0.6*	*-1.3*		
Current balance		*-0.1*	*-0.2*	*-1.1*	*-2.0*		

.. not available.
(a) The oil exporting countries covered are defined in the statistical annex in the additional notes to Table 16.
(b) Provisional.
(c) Includes Spain and Portugal.
(d) Includes holdings of gold.

International capital markets[1]

The article on page 58 examines developments in international capital markets in 1985. This section concentrates on developments in the three months to February.

After a trough in December, partly explained by seasonal factors, activity in the international capital markets picked up in January and February. Announcements of syndicated credits rose during January and February (from a very low base) and there was a continuing high level of activity in the fixed-rate bond markets. Euronote announcements rose to record levels in February, following a sharp fall in January.

(1) From this issue of the *Bulletin* the figures for all types of instrument will be compiled by announcement date. (Fixed-rate bonds and FRNs were formerly compiled by completion date.)

Issues of FRNs declined owing to unfavourable market conditions and the popularity of alternative forms of borrowing, notably euronotes and fixed-rate bonds.

Fixed-rate bonds

Fixed-rate international bonds totalling $36.9 billion were issued during the three months to February, a rise of 10% over the previous three months. This rise took place despite a seasonal decline in the number of bonds announced during December. US and Japanese borrowers combined accounted for about 40% of new issues.

Announced international bond issues[a]

$ billions; *percentages in italics*

	1984	1985				1986	
	Year	Q1	Q2	Q3	Q4	Jan.	Feb.
Fixed-coupon bonds							
Borrower:							
Major OECD countries	46.8	16.1	16.0	18.3	20.1	9.0	11.8
of which:							
United States	20.0	6.6	6.2	8.4	9.0	3.9	3.9
Japan	14.4	5.6	4.7	4.6	4.1	1.9	2.2
Minor OECD countries	12.8	3.6	5.5	3.7	5.5	2.9	2.7
International institutions	12.4	3.7	2.8	5.1	4.3	1.8	2.0
Other	2.0	0.6	1.0	0.8	0.5	0.4	0.4
Total	**74.0**	**24.0**	**25.3**	**27.9**	**30.4**	**14.1**	**16.9**
Currency:							
US dollars	*50.1*	*49.4*	*51.1*	*42.9*	*44.9*	*53.3*	*50.3*
Swiss francs	*17.4*	*13.4*	*11.3*	*11.2*	*18.2*	*11.6*	*16.2*
Yen	*8.0*	*10.4*	*9.0*	*13.9*	*11.5*	*18.3*	*9.4*
Other	*24.5*	*26.8*	*28.6*	*32.0*	*25.4*	*16.8*	*24.1*
Floating-rate notes							
Borrower:							
Major OECD	21.6	8.6	11.4	7.1	11.5	2.8	1.2
Minor OECD	9.6	3.1	2.8	1.1	1.1	1.3	0.2
Other	2.8	2.4	2.9	1.5	1.8	1.1	0.2
Total	**34.0**	**14.1**	**17.1**	**9.7**	**14.4**	**5.2**	**1.6**

(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.

Canadian borrowing totalled $2.3 billion during February alone: this included a $1 billion federal government issue which forms part of a package of borrowing designed to build up reserves following recent falls in the exchange value of the Canadian dollar.

Sovereign borrowing amounted to $4.4 billion, 50% more than in the previous three months, underlining the current popularity of fixed-rate borrowing compared with FRNs. As well as a total of $1.4 billion for Canada, Sweden raised $690 million.

The proportion of issues denominated in dollars rose to 51%, compared with 44% in the preceding three months. The proportion of new bond issues denominated in yen was 14% compared with 11% during 1985 as a whole. The increasing share of yen-denominated issues is partly explained by the popularity of dual-currency bonds that carry a coupon denominated in yen, but are redeemed in dollars.

Issues in Australian dollars increased, with $1.2 billion of new bonds announced, reflecting the continued availability of profitable currency swap opportunities. In contrast, new issues denominated in ECU declined to $0.7 billion, amid expectations in the markets of a realignment within the EMS basket of currencies.

Fixed-rate bonds at long maturities have become increasingly popular. Borrowers have taken advantage of a flattening of yield curves to issue long-dated bonds at relatively low spreads over comparable short-term bonds. Between December and February, $2.3 billion of bonds with maturities of thirty years or more were issued, including $1.5 billion for the World Bank. Four perpetual issues denominated in Swiss francs were announced in the period: two, both for Air Canada, have no call options for the first fifteen years, while the other two carry a coupon to be reset every ten years. Thirty-year maturities with no call option have also been employed in the form of both zero-coupon and conventional fixed-rate bonds: such maturities have previously been limited to the US and UK domestic bond markets. These bonds appeal to investors who have experienced declining yields on recent new issues and a fall in the average maturity of their portfolios as call options have been exercised on outstanding bonds (call options on a total of $17.2 billion of fixed-rate bonds and FRNs are estimated to have been exercised during 1985).

Floating-rate notes

Announcements of FRN issues in the three months to February totalled $8.2 billion, $10 billion less than in the preceding three months. Seasonal effects, with a limited volume of new issues during December, accounted for a small part of this decline but other factors made a more significant contribution. The eurodollar interbank yield curve remained flat, limiting the gains to institutional and bank investors from holding FRNs and funding them through short-term borrowing in the money markets. Heavy inventories of unsold FRNs issued during October and November, in particular issues by US banks and savings and loans institutions, also depressed the new issue market. Finally, a number of prime quality borrowers found it possible to achieve lower costs using fixed-rate eurodollar bond issues which were subsequently swapped into floating-rate funds. The differential between the coupon on the initial bond issue and the higher fixed rate paid by the swap counterparty can be deducted from the cost of floating-rate funds under the swap to achieve sub-Libor borrowing costs overall.

Financial institutions' and sovereign borrowing accounted for 89% of FRNs issued between December and February. There was a substantial fall in the volume of issues by US banks and financial institutions, which raised only $1 billion in the latest three-month period, compared with $5 billion between September and November. Issues of FRNs by UK banks and building societies fell from $3 billion to $1.6 billion, in line with the fall in total FRN issues. Sovereign borrowing totalled $2.2 billion, 50% lower than in the preceding three months. Major issuers were Belgium and the EEC. The latter issued two FRNs as part of a funding package for Greece arranged under the auspices of the Community.

The proportion of FRNs denominated in dollars continued to fall, averaging 74% between December and

February, compared with 87% during 1985 as a whole. On the other hand, the share of borrowing denominated in sterling and deutschemarks continued to rise, in particular the latter which accounted for 11½% of FRNs announced, compared with 8½% in the preceding three months. There were no issues denominated in yen. Following the deregulation of the Dutch capital markets, the first FRN denominated in guilders was issued in January.

Euronote facilities

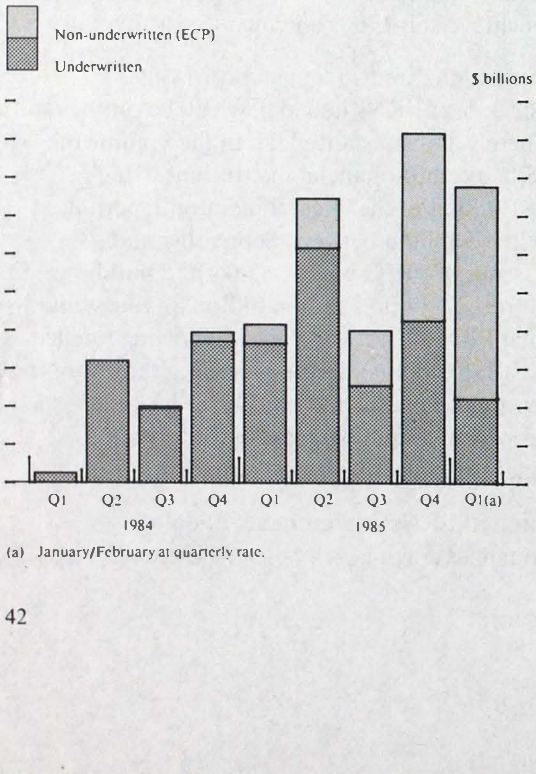
This section covers facilities for the issue of short-term euronotes (including CD issuance facilities and eurocommercial paper), whether or not backed by bank commitments.

Announcements of euronote facilities totalled $15.6 billion in the three months to February, with the total for February alone up to the record level of $7.5 billion following a sharp fall in January.

Although new variants on the euronotes theme continue to emerge, three main types are now identifiable: first, uncommitted or non-underwritten eurocommercial paper (ECP) programmes; second, underwritten euronote facilities (NIFs and RUFs); and, third, multiple-component facilities (NIFs and RUFs with extra borrowing options).

Nearly all facilities continue to be for borrowers from OECD countries. US, Australian and UK borrowers continue to be the most active, but there has also been increasing activity by borrowers from Norway, Finland and Italy: New Zealand arranged a facility for $1 billion. More than 50% of new facilities (by value) are now non-underwritten or uncommitted (commonly known as eurocommercial paper). However, there are marked differences in the preference of different nationalities of borrowers for underwritten or non-underwritten facilities. Minor OECD countries in general make greater use of non-underwritten facilities (two thirds) than major OECD countries (a half). Countries whose borrowers

Euronote facilities



(a) January/February at quarterly rate.

Announced euronote facilities[(a)]

$ billions

	1984 Year	1985 Q1	Q2	Q3	Q4	1986 Jan.	Feb.
Committed(b)	18.20	7.30	12.33	5.01	8.50	0.89	2.05
Uncommitted	0.64	1.00	2.59	2.96	9.80	1.94	5.44
Total	**18.84**	**8.30**	**14.92**	**7.97**	**18.30**	**2.83**	**7.49**
of which:							
Major OECD	*6.40*	*4.86*	*9.52*	*4.22*	*10.66*	*1.30*	*4.27*
Minor OECD	*11.20*	*3.05*	*4.23*	*3.34*	*6.93*	*1.03*	*3.12*
Other	*1.24*	*0.39*	*1.17*	*0.41*	*0.71*	*0.50*	*0.10*
Selected nationalities of borrower							
United States	3.16	3.29	6.47	1.84	5.88	0.50	1.40
France	1.24	0.30	1.41	0.58	0.70	0.15	0.64
United Kingdom	0.72	0.58	0.32	1.00	1.92	—	1.48
Australia	2.72	1.37	0.89	1.68	3.96	0.17	0.35
Sweden	4.72	0.65	2.65	1.20	0.32	0.15	0.90

(a) Revised data. Includes all facilities providing for the issues 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.

display a strong preference for ECP are the United Kingdom, Norway, Finland and Sweden, and many others show signs of moving that way.

A number of top borrowers have been able to arrange underwritten facilities very cheaply. Multiple-component facilities for Gaz de France ($700 million) and Italy's ENEL ($400 million) carried annual facility fees of just five basis points.

Among non-OECD countries, there have recently been borrowers from India (the first tax-spared RUF), Singapore, Malaysia, Bahrain, Thailand, Kuwait and the African Development Bank. A facility was arranged in the name of a Mexican bank, but guaranteed by a US bank and, therefore, US rather than Mexican risk.

As more flexible types of facilities have become available, a number of borrowers have either cancelled existing facilities and replaced them with new ones or kept existing ones after improvements. Most notable was the renegotiation of the terms of the Kingdom of Sweden's 1984 multiple-component facility, which included halving the amount to $2 billion.

Syndicated lending

After totalling only $3.2 billion in the fourth quarter of 1985, borrowing in the syndicated credits market picked up in January and February to the highest level for nearly a year. Although the terms on which most borrowers are able to obtain access to funds have continued to improve, very few have taken the opportunity to make new borrowings. However, renegotiations of the terms on existing borrowings—which are not included here as they represent changes to old loans rather than new business—have continued to be numerous.

Among OECD countries, there have recently been new loans for borrowers from Italy (many in ECU), Turkey (including a World Bank co-financing) and Belgium. Eastern bloc borrowers have continued to be active in the market, with Bulgaria, the USSR, East Germany and Hungary announcing sizable new credits. East Germany

Announced eurocurrency syndicated credits
$ billions

	1984	1985				1986	
	Year	Q1	Q2	Q3	Q4	Jan.	Feb.
Major OECD	9.90	1.70	0.86	1.10	1.40	1.31	0.73
Minor OECD	6.16	1.66	1.39	0.86	0.49	0.49	0.17
Developing countries	7.17	1.20	1.35	1.29	0.08	0.34	0.56
Eastern bloc	2.19	0.64	1.74	0.71	0.46	0.35	0.15
Other	4.69	0.49	0.26	0.54	0.70	0.40	0.60
Total	**30.11**	**5.69**	**5.60**	**4.50**	**3.13**	**2.89**	**2.21**
of which, transferable	*1.49*	*1.58*	*1.02*	*1.62*	*1.55*	*0.62*	*1.08*

has also entered into negotiations for changes to existing loans—the first Eastern bloc country to do so.

Developing countries have raised little 'spontaneous' new finance, with only South Korea, Algeria, India, the Bahamas and Thailand raising market loans. Banks' commitments under rescheduling and new money packages were $4.2 billion in the fourth quarter, bringing total syndicated lending to developing countries to just $7.5 billion (compared with $20.9 billion in the same quarter of 1984).

International banking developments

Activities of banks in the BIS reporting area in the year to end-September 1985 are described in the article on page 58. This section focuses mainly on developments in the international business of banks in the BIS area in the third quarter and, separately, of banks in the United Kingdom in the fourth quarter.

Banks in the BIS reporting area (third quarter of 1985)
The rate of growth of BIS-area banks' cross-border lending increased in the third quarter, after weak growth in the second quarter. The pick-up was largely the result of strong growth of Japanese banks' interbank activity, connected with window-dressing operations over the mid-point of their financial year. There was also a large rise in foreign currency claims on domestic residents, again associated with the expansion of Japanese banks' interbank business.

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

	1983	1984	1985			Outstanding at end-Sept.
	Year	Year	Q1	Q2	Q3	1985
Deposits from						
Outside reporting area:						
Developed countries	+ 2	+ 3	—	+2	+ 2	34
Eastern Europe	+ 3	+ 4	− 3	+2	+ 2	25
Oil exporting countries	− 14	+ 2	+ 1	−1	+ 2	152
Non-oil developing countries	+ 10	+ 20	− 1	—	—	171
of which, Latin America	*+ 6*	*+ 10*	—	—	*− 1*	*68*
Sub-total	+ 1	+ 30	− 4	+3	+ 6	383
Inside reporting area(a)	+105	+118	+63	−4	+38	1,871
Unallocated	+ 4	− 1	− 2	−2	+ 5	58
Total	**+111**	**+146**	**+57**	**−3**	**+49**	**2,311**
Lending to						
Outside reporting area:						
Developed countries	+ 7	+ 6	+ 1	+2	+ 1	96
Eastern Europe	− 1	—	− 1	+3	+ 2	57
Oil exporting countries	+ 10	− 2	− 1	−2	—	107
Non-oil developing countries	+ 12	+ 10	− 2	+3	+ 4	342
of which, Latin America	*+ 8*	*+ 6*	—	—	*+ 1*	*216*
Sub-total	+ 28	+ 14	− 2	+6	+ 7	603
Inside reporting area(a)	+ 74	+107	+56	—	+27	1,695
Unallocated	+ 4	—	+ 1	+2	+ 1	49
Total	**+106**	**+121**	**+55**	**+8**	**+35**	**2,347**

(a) Including non-reporting offshore centres.

Estimated lending to final users, a measure which includes external lending *and* foreign currency claims on residents, also picked up in the third quarter. Most of the increase reflected domestic lending by banks in the United States which was funded by euromarket borrowing. Despite the upturn in both interbank business and lending to final users in the third quarter, the underlying rate of growth of international bank lending remained subdued. The omission of part of banks' purchases of bonds from the statistics has, however, led to some understatement of the international lending of banks.

Lending to outside-area countries, although still generally depressed, was slightly stronger than in the second quarter. The increase was, however, concentrated on a few creditworthy countries. Nearly two thirds of the new lending was to Asia, with China taking by far the largest share. Claims on Eastern Europe rose again, although not as strongly as in the second quarter. Lending to Latin America also increased modestly, and largely comprised the disbursal of new 'package' money to Argentina. At the same time, outside-area countries increased their deposits with banks in the BIS reporting area. Overall, as in the first two quarters of 1985, outside-area countries were modest net takers of funds from the international banking markets.

The recent move towards currency diversification of international banking flows did not continue in the third quarter, when the US dollar resumed its dominance, accounting for 70% of new cross-border lending. At end-September 1985, the dollar accounted for two thirds of outstanding claims. Euroyen business contracted after strong growth in the second quarter, while the use of sterling declined again. Deutschemark, Swiss franc and ECU business, on the other hand, expanded in the third quarter.

The latest half-yearly maturity analysis of the consolidated claims of banks in the BIS reporting area at end-June 1985 showed a slight shortening in the maturity of the banks' claims, in contrast to 1984 when there were substantial rescheduling operations. There was a modest increase in undisbursed credit commitments in the first half of 1985, after a fall in the second half of 1984.

The London market (fourth quarter of 1985)
After particularly strong growth in the third quarter of 1985, international lending undertaken by banks in the United Kingdom moderated somewhat in the final quarter of the year. Growth was nonetheless stronger than in the first half. The fourth quarter slowdown was in foreign currency lending in the London interbank market and the rate of cross-border lending was little changed from the third quarter. Direct lending overseas which can be allocated geographically (see accompanying table) grew slightly less quickly, but 'securitised' lending (which is not shown in the table) expanded at a record pace.

Information is now collected on the geographical distribution of UK banks' cross-border securitised

External business of banks in the United Kingdom

$ billions; changes exclude estimated exchange rate effects

	1984	1985				
	Year	Year	Q1	Q2	Q3	Q4
Deposits from:						
BIS reporting area(a)	+25.3	+39.0	+12.7	+0.5	+14.0	+11.8
'Offshore' banking centres(b)	+ 6.8	+ 5.1	+ 3.4	−0.1	+ 0.9	+ 0.9
Sub-total	+32.1	+44.1	+16.1	+0.4	+14.9	+12.7
Developed countries	+ 1.4	+ 1.5	+ 0.3	+0.5	+ 1.2	− 0.5
Eastern Europe	+ 0.9	+ 1.3	− 0.8	+0.7	+ 0.7	+ 0.7
Oil exporting countries	− 1.2	+ 1.8	− 0.1	+2.4	− 1.1	+ 0.5
Non-oil developing countries	+ 4.8	− 1.0	− 0.6	+0.1	− 1.6	+ 1.1
of which, Latin America	*+ 2.9*	*− 2.2*	*− 0.2*	*−0.7*	*− 0.5*	*− 0.8*
Sub-total	+ 5.9	+ 3.6	− 1.2	+3.7	− 0.8	+ 1.8
Others	− 1.8	− 0.7	− 0.2	+0.8	+ 0.2	− 1.4
Total	**+36.2**	**+47.0**	**+14.7**	**+4.9**	**+14.3**	**+13.1**
Lending(c) to:						
BIS reporting area(a)	+15.2	+26.2	+ 8.5	−4.7	+12.4	+10.0
'Offshore' banking centres(b)	+ 9.3	− 4.8	+ 0.2	+1.0	− 3.7	− 2.3
Sub-total	+24.5	+21.5	+ 8.7	−3.7	+ 8.7	+ 7.7
Developed countries	+ 1.2	+ 2.3	+ 0.5	+0.4	—	+ 1.4
Eastern Europe	− 0.4	+ 3.3	− 0.1	+1.1	+ 1.3	+ 1.0
Oil exporting countries	− 1.0	− 0.5	+ 0.1	−0.3	− 0.5	+ 0.2
Non-oil developing countries	+ 1.1	+ 2.8	− 0.8	+1.0	+ 1.9	+ 0.8
of which, Latin America	*+ 1.9*	*+ 1.5*	*− 0.3*	*+0.1*	*+ 1.8*	*− 0.1*
Sub-total	+ 0.8	+ 7.9	− 0.3	+2.2	+ 2.7	+ 3.4
Others	—	+ 2.5	+ 0.4	+0.7	+ 1.6	− 0.2
Total	**+25.3**	**+31.9**	**+ 8.8**	**−0.8**	**+13.0**	**+10.9**

(a) Excluding 'offshore' reporters.

(b) Including BIS reporters and other 'offshore' centres.

(c) 'Securitised' lending is not included.

lending, and the first statistics relate to end-December 1985 (see Table 14 of the statistical annex). At that date, 85% of the overseas bonds held by banks in the United Kingdom represented claims on residents of BIS reporting area countries and the 'offshore' centres. Bonds issued by developed countries outside the BIS area accounted for a further 6% of total holdings and those by international organisations for an additional 3%. The bonds of non-oil developing countries represented only 4% of the total. Bonds issued by newly-industrialising countries in the Far East, notably Malaysia, accounted for almost two thirds of total holdings of securities of non-oil developing countries, and can be presumed largely to represent new securitised lending undertaken in the past three years. This is not the case with the substantial holdings of Mexican bonds. Almost three quarters of the bonds held by UK banks at the end of 1985 were dollar-denominated, while just under one tenth were sterling bonds. The bonds held represented claims on overseas non-banks and banks in almost equal proportions.

The principal feature of the non-securitised lending in the fourth quarter was the further modest increase in the rate of lending to countries outside the BIS area. All the major country groups increased their borrowing from UK banks in the quarter, although, within the non-oil developing country total, claims on Latin America fell slightly. The Soviet Union was by some distance the country with the largest total borrowing. Some of the pick-up may be seasonal in nature.

Outside-area countries increased their deposits with UK banks by almost $2 billion in the quarter. But within the aggregate, the deposits of Latin American countries, principally Mexico and Brazil, fell again.

Foreign exchange and gold markets

This section reviews the three months to end-February.

During the period under review, most major currencies, with the exception of sterling, continued the trends established following the meeting last September of the Finance Ministers and central bank Governors of the Group of Five industrial countries (the G5). After an initial pause, the dollar resumed its downward trend in late December, to reach a four-year low against the deutschemark and a seven-year low against the yen. Sterling was adversely affected by the sharp fall in oil prices and failed to derive as much benefit from the dollar's fall as most other major currencies. The European Monetary System (EMS) at times came under pressure as outflows from the dollar boosted the deutschemark.

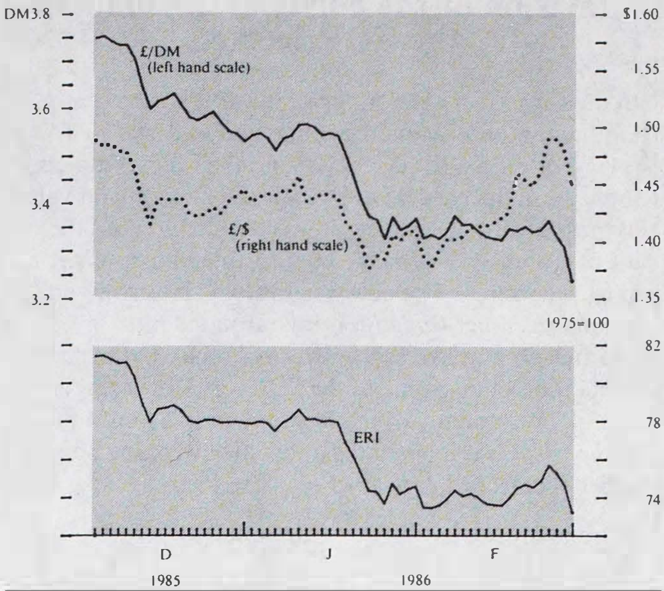
Sterling

The most important influence on sterling over the three months to end-February was the sharp fall in spot oil prices that followed OPEC's decision in early December to try to recapture its lost share of the world oil market. The pressure on the pound was accentuated for a time by the political repercussions of the Westland affair. In highly volatile trading conditions, sterling was unable to match the gains made by other major currencies against the weaker dollar and touched all-time lows against the deutschemark, guilder, Swiss franc and yen. In response to sterling's weakness, UK money-market interest rates firmed and clearing banks increased their base rates by 1% to 12½% on 8 January. A rally in oil prices temporarily relieved the pressure on the pound in the last half of February. It made up some ground against the weaker dollar but not against Continental currencies and then fell back generally as oil prices weakened again.

The pound opened the period on 2 December on a firm note at ERI 81.2, $1.4872 and DM 3.7347 in London and advanced to $1.5020 (a 26-month high) and DM 3.7559. However, fading expectations of an early cut in the US discount rate triggered a strong dollar rally. Sterling fell back to $1.4735 on 3 December and then again as nervousness developed ahead of the OPEC meeting scheduled for the weekend of 7–8 December. After reports that OPEC had decided to 'secure and defend a fair share of the world oil market', rather than defend price levels, some sizable selling of sterling developed in the Far East on the morning of 9 December. The pound subsequently found some support at lower levels in Europe but continued to fall back in New York and the Far East. On 10 December, in very active trading, the pound was marked down to $1.4295 in London before it steadied on the release of the November money supply figures and statements by the Prime Minister in Parliament, which seemed to rule out the prospect of any early fall in UK interest rates. After some short-lived pressure on 11 December, the pound continued to strengthen as conditions in the oil market calmed and the dollar was depressed by expectations of an imminent cut in the US discount rate. Following reaffirmation by the

Sterling exchange rates

At the close of business in London each day



Government of its resolve to contain inflation, good commercial demand took sterling up to $1.4465 on 13 December before oil prices resumed their downward path and commercial selling took the rate lower again in a thin pre-holiday market, to $1.4165 on 19 December. Although some benefit was received from the weaker dollar, the withdrawal of many professionals from the market exposed sterling to more commercial selling and it closed at midday on Christmas Eve at $1.4245. Pressures eased somewhat in the quiet conditions between Christmas and the New Year but, even with the dollar weakening quite rapidly following some poor US economic indicators, the pound rose no higher than $1.4510 on 30 December and eased back to finish the year at ERI 77.9, $1.4455 and DM 3.5299.

Sterling opened on 2 January somewhat firmer on sizable demand in the Far East but commercial selling soon reappeared. While some support was received on 8 January from expectations of a rise in clearing banks' base rates in response to firmer money-market interest rates, the actual announcement of a 1% increase to 12½% had little apparent impact. Moreover, the pound was depressed by news of the resignation of the Secretary of State for Defence and initially failed to derive any significant benefit when the dollar came under heavy selling pressure in New York after rumours of the possible liquidation of US investments by Middle East holders following the US financial freeze on Libyan assets. Sterling eventually reached $1.4670 on 10 January, but met widespread selling. It was further undermined by renewed oil price weakness and developments in the Westland affair and fell to $1.4319 on 13 January. Sterling's weakness then generated speculation about further UK interest rate increases and the pound rallied to $1.4470 on 14 January.

Although the Bank of England resisted a further rise in base rates, there was only a limited impact on sterling, which received support from expectations that the G5 would discuss concerted interest rate cuts at their London meeting scheduled for 18–19 January. In the event, no new policy initiative was forthcoming and sterling relapsed on oil price considerations, weakening particularly on 23 January as oil prices fell following the Saudi Oil Minister's comment that there was 'no limitation to the downward spiral'. An attempted recovery on 24 January was halted by news of the resignation of the Secretary of State for Trade and Industry. In nervous conditions, sterling moved down to $1.3745 and DM 3.3084 on 27 January. The pound recovered some strength on 28 January in advance of and following the Prime Minister's statement in Parliament on Westland, helped by a sharp recovery in oil prices and the good UK December trade figures. Sterling then fluctuated with oil prices. As these improved slightly, the pound reached a high of $1.4175 on 31 January before being marked down ahead of the OPEC conference scheduled for 3 February, to finish at ERI 74.6, $1.4086 and DM 3.3687.

Following press comment over the weekend of 1–2 February (some of which revived earlier speculation that there had been heavy intervention to support the pound) and various pessimistic statements by OPEC members, sterling weakened dramatically on 3 February in the Far East, where it recorded DM 3.2910. Sterling's decline accelerated in the Far East the next morning on suggestions that oil prices might fall to $10 a barrel, and the pound touched a London low for the period of $1.3665. At these levels, there was strong commercial demand. The release of unexpectedly good January money and reserves figures also helped the pound. This firmer tone was reinforced on 5 February by reports that the UK Oil Minister was to meet his OPEC counterparts at a weekend oil seminar in Norway, although the rate fell back slightly after official denials. Good commercial demand on 6 February and the reaction of oil prices to rumours that some Middle Eastern oil exporters (including Saudi Arabia) were contemplating production cutbacks took the pound to $1.4103 and DM 3.3749 on 7 February. Further progress against the falling dollar was inhibited for a time thereafter by renewed softness in oil prices, worries about the default of a major oil trader and re-emergent domestic political concerns. Some good demand developed on 18 February as oil prices stabilised on hopes of production cutbacks by OPEC, but progress against Continental currencies was muted.

Remarks by the Saudi Oil Minister about ensuring that oil prices returned to acceptable levels allowed the pound to capitalise on the dollar's weakness and, in active trading, it advanced to $1.4960 and DM 3.3663 on 25 February. However, this rally was quickly cut short by profit-taking and market unwillingness to breach $1.50. With the deutschemark the main beneficiary of the dollar's fall, sterling lost ground sharply. As the dollar then stabilised at about DM 2.20 and ¥180, and as oil prices eased, the pound weakened generally to finish the

Changes in UK official reserves
$ millions

	1985	1986	
	Dec.	Jan.	Feb.
Change in reserves	**-433**	**+ 17**	**+250**
of which:			
Net borrowing (+)/payment (-) of public debt	- 17	+ 63	+138
Valuation change on roll-over of EMCF swap	—	-178	—
Underlying change in reserves	-416	+132	+112
Level of reserves (end of period)	**15,543**	**15,560**	**15,810**

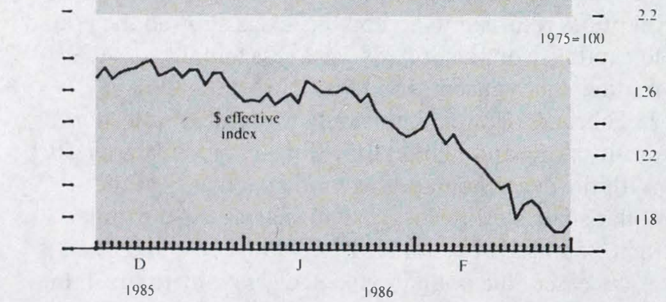
period at ERI 73.2 (-10% over the period), $1.4505 (-2⅝%) and an all-time low of DM 3.2368 (-13½%).

Official reserves
Over the three months to end-February, there was an underlying decrease in UK reserves of $172 million. Net public sector borrowing under the exchange cover scheme totalled $307 million, while $123 milion was repaid in respect of long-term North American loans. There was a contribution to reserves related to a part of the European Community budget abatement and a decrease of $178 million on account of the valuation adjustment arising from the quarterly roll-over of the UK's ECU holding with the European Monetary Co-operation Fund. At the end of February, the reserves stood at $15,810 million.

US dollar
The process of adjustment to the value of the dollar initiated by the G5 meeting last September continued over the period under review. The previous three months had been characterised by heavy concerted intervention by central banks (reported as amounting, over the first six weeks following the September meeting, to $3.2 billion by the Federal Reserve, some $5 billion by other G5 central banks and about $2 billion by five other industrial country central banks) and a tightening of monetary policy in Japan. The latest period marked a new phase, which opened with a pause in the depreciation of the dollar. This was most apparent against the yen, the rise in which levelled out following the relaxation of short-term

Dollar exchange rates

At the close of business in London each day



Revision of the currency amounts in the SDR basket

In the December 1985 *Bulletin*, it was reported that the International Monetary Fund had 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 this review, it was decided to keep the list of currencies unchanged but to amend the weight of each currency. The new weights (which were given in the December *Bulletin*) were translated into nominal amounts of each currency, for use in the daily calculation of the value of the SDR, on 31 December 1985. The amounts, which will remain fixed until the next review is implemented and which were introduced with effect from 1 January 1986, are:

Currency	Amount
US dollar	0.452
deutschemark	0.527
Japanese yen	33.4
French franc	1.02
pound sterling	0.0893

interest rates and, apparently, in response to official remarks questioning the desirability of further rapid appreciation and, in particular, to Governor Sumita's statement that the rate should not move through ¥200 before the May economic summit. The dollar resumed its fall in late December, reflecting persistent doubts about US economic prospects and the general belief that the Federal Reserve was adopting a more accomodative policy, which was expected to lead to an imminent cut in its discount rate. In addition, the dollar reacted to an easing in long-term US interest rates following a strong performance in the bond market which was encouraged by hopes that the Gramm-Rudman-Hollings legislation would cut back the US budget deficit and that lower oil prices would trim inflation. The dollar's descent continued, however, even when expectations of a US discount rate cut were shelved and, with long-term interest rates recovering some strength as US economic indicators began to improve, the bond market rally temporarily petered out. Underlying sentiment appeared to remain bearish as lower oil prices were interpreted as providing greater benefit to the economies of Continental Europe and, in particular, Japan, than to the United States, because of the greater dependence of the former on oil imports and the oil-related exposure of US banks, both at home and abroad.

With the yen restrained by official caution, outflows from the dollar moved initially into the deutchesmark. However, reports that Finance Minister Takeshita saw a range of ¥190–200 as acceptable reactivated the yen, which then surged ahead of other major currencies. Subsequently, the dollar was affected by official statements from the United States which indicated a desire for further depreciation to facilitate correction of the US trade deficit. On 27 February, the dollar touched lows of DM 2.2015 and ¥177.87, but recovered some ground on rumours that the G5 were to meet urgently to try to brake the dollar's fall, possibly through discount rate cuts in Germany and Japan. The dollar finished the period at DM 2.2315 (−11⅛% over the period), ¥180.70 (−10½%) and 117.8 on a Bank of England effective index (−6¾%). From the close of business in New York just before the G5 meeting last September to the end of February, the dollar fell by 21½% against the deutschemark, 24¼% against the yen and 15⅝% in effective terms.

EMS

The exchange rate mechanism of the EMS was subject to renewed tensions over the period under review as the main outflows from the weakening dollar initially moved into the deutschemark and sparked rumours of an early re-alignment. In December and again in February, the narrow band was fully stretched. The system also exhibited some clustering, with the deutschemark, Dutch guilder, French franc and Italian lira together at the top, the Belgian franc and Irish pound at the bottom, and the Danish krone in the middle of the band. The Irish pound reflected the weakness of sterling, while the Danish krone was apparently affected by political uncertainty following the Danish Parliament's rejection of the EEC Treaty reform package.

Pressure on a number of currencies required action by the authorities: in Italy, credit and exchange controls were tightened and short-term interest rates increased; the Belgian discount rate was raised by 1% in December; and Irish money-market intervention rates were increased. Euro French franc and euro Belgian franc interest rates also firmed sharply in the middle of the period. Although pressures occasionally subsided, the narrow band remained distended, finishing the period almost 2¼% wide: the deutschemark remained at the top of the system for most of the period, but was occasionally displaced by the French franc and the guilder; the Belgian franc remained the weakest currency throughout. The lira finished ⅛% below the top of the narrow band.

Other currencies

The yen appreciated over the period under review by 10½% to ¥180.70 against the dollar and by 7⅛% in effective terms to 189.9.

The Swiss franc made very strong gains in February. This recovery was triggered by bond conversions but also reflected a suspicion that further appreciation of the deutschemark and the yen might meet resistance from central banks and, possibly, a reaction to worries about default by some oil-exporting debtor countries (to which the Swiss financial system seemed less exposed). The Swiss franc subsequently retained much of its strength and finished the period at Sw.Fc.1.8807, a gain of 9⅝%, and at 156.3 in effective terms, a gain of 2⅝%.

The Canadian dollar came under heavy pressure in January, reflecting worries about the budget deficit, oil price weakness and what was perceived as official indifference to the exchange rate. It consequently failed to benefit from the weakness of the US dollar and a low of Can $1.4465 was touched on 4 February. Aggressive intervention by the Bank of Canada in the foreign exchange and domestic money markets, backed up by action to bolster reserves by drawing from commercial credit lines and by the issue of a US $1 billion eurobond, temporarily rallied the Canadian dollar but it fell back following negative assessments of the budget presented on 26 February. The Canadian dollar finished the period 3⅛% lower at Can $1.4255 and down 6¼% in effective terms at 76.8.

Gold

Gold was very active and extremely volatile at times during the period. It initially failed to respond to the dollar's fall but improved following the emergence of tensions between the United States and Libya, and drew some strength from firmer platinum prices. The gold price rose to $375 on sizable demand on 16 January but then fell back to lower levels as demand subsided against a background of falling oil and platinum prices. The final fixing in London in February was $338.15, up $12.85 over the period.