

# International financial developments

Among the main developments:

- The sharp fall in oil prices was reflected in a widening of the current account deficit of the oil exporting countries in the first quarter of 1986 and some modest strengthening of the current account positions of oil importers, including the United States, where the deficit is estimated to have fallen back from its end-year peak;
- Activity in the international capital markets reached record levels in the three months to May, with the emphasis mainly on new issues of fixed-rate bonds, which rose by over 40% in the period, although volume fell back in May as the general rally in world bond markets came to an end: unfavourable market conditions continued to depress activity in the FRN sector;
- The fourth quarter of 1985 saw record growth in cross-border interbank business in the BIS reporting area. However, amid continuing nervousness about the risks inherent in cross-border lending, new loans to countries outside the main financial centres were highly selective, with only five countries absorbing as much as 95% of the increase in BIS-area banks' 'spontaneous' lending in 1985;
- In the foreign exchange markets, the downward trend in the dollar apparent since the G5 meeting in September was not sustained in the three months to May and the effective rate strengthened marginally over the period. The EMS was realigned following the French elections in April.

## Balance of payments positions

The combined current account deficit of the *major seven economies* is estimated to have been broadly unchanged in the first quarter of 1986 following the rise recorded in the previous three months. There was a further rise in the German current account surplus but the Japanese surplus levelled out as gains in the terms of trade were offset by a fall in export volume following the appreciation of the yen over the past year. The US current account deficit is estimated to have narrowed slightly from the previous quarter's record level, with lower oil prices helping to offset further increases in import volumes.

The estimate of the combined current account deficit of the *smaller OECD countries* for the first quarter suggests little change from the relatively stable profile recorded during 1985. It is likely, however, that the fall in oil prices recorded during the first quarter will be reflected in a decline in the combined deficit during the middle quarters of this year.

The current account position of the *oil exporting countries* is estimated to have deteriorated further during the first quarter, reflecting a marked decline in export receipts associated with the fall in oil prices. The improved current account position of oil importing countries and the deterioration in the combined OPEC current account deficit may become more marked if oil prices remain

## World current accounts<sup>(a)</sup>

\$ billions; seasonally adjusted

	1984		1985(b)			1986(b)
	Year	Year	Q2	Q3	Q4	Q1
OECD economies:						
Canada	3	-2	—	-1	-1	-3
France	—	-1	1	—	1	1
Germany	7	14	3	4	5	8
Italy	-3	-4	-2	2	—	-1
Japan	35	49	12	12	16	16
United Kingdom	1	4	2	1	1	1
United States	-107	-118	-28	-29	-37	-35
Major economies	-64	-56	-12	-11	-15	-13
Other OECD	-2	-2	—	-1	-2	-2
Total OECD	-66	-58	-12	-12	-17	-15
OPEC economies	-9	-4	—	-1	-3	-5
Other developing economies	-18	-26	-6	-7	-9	-5
Other economies(c)	6	6	2	1	1	1
World discrepancy(d)	-87	-82	-16	-19	-28	-24

(a) Components may not add due to rounding.

(b) Includes Bank estimates/forecasts.

(c) South Africa and the centrally planned economies.

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

below \$20 per barrel. Import retrenchment by OPEC countries may, however, offset the impact of declining oil-related income on the current account to some extent.

The current account deficit of the *other developing economies* is estimated to have increased from \$18 billion to \$26 billion between 1984 and 1985. The major part of the deterioration was due to the turnaround in the



Chinese current account, but there was also a sizable decrease in Mexico's surplus. By contrast, the current account positions of Argentina, Chile, Israel, South Korea and the Philippines are all estimated to have strengthened, and the Taiwanese surplus increased further from \$7 billion in 1984 to \$9 billion last year.

Capital flows within the *major industrial economies* in 1985 were, for the third year in succession, dominated by inflows into the United States to finance the massive current account deficit. Whereas in 1984 net direct investment and bank reported capital flows accounted for much of the net inflow of funds into the United States, in 1985 net portfolio investment accounted for two thirds of the net inflow, with non-resident portfolio investment doubling to \$72 billion. Around one third of the portfolio capital flows was in the form of purchases of US Treasury bonds, with Japanese residents by far the largest investors. The strong portfolio inflow in part reflected the wide interest rate differential that existed between US and foreign markets during much of 1985, while expectations of declining US inflation and rising bond prices may have attracted some investors. Much of the counterpart to the strong US capital inflow can be found in the outflow of portfolio investment from Japan which rose to \$43 billion in 1985, from \$24 billion a year earlier.

Capital inflows to the *non-oil developing countries* were more than sufficient to cover the current account deficit in the fourth quarter of 1985. Borrowing from banks and through bond issues were particularly strong in the quarter and for the year as a whole totalled \$9 billion and \$6 billion respectively. Malaysia in particular borrowed heavily through bond issues in the fourth quarter (and over 1985 as a whole accounted for half of all developing country issues of floating-rate notes). Concessionary and other official flows are estimated to have been at much the same level as in the previous three months but were sharply lower over the full year. There was a slight increase in reserves in the final quarter but this was not sufficient to offset the sharp decline early in the year, leaving a net fall in reserves in 1985 as a whole of over \$9 billion.

### Developing countries' balance of payments

\$ billions; not seasonally adjusted

	1984		1985(a)			
	Year	Year	Q1	Q2	Q3	Q4
Current account	-18	-26	-5	-8	-5	-9
Capital account	30	15	-4	8	3	10
of which:						
Concessionary and other official flows	27	18	4	4	5	5
Direct investment	8	8	2	2	2	2
Borrowing from banks(b)	10	9	-2	3	2	5
Borrowing via bond issues (gross)	3	6	1	2	1	3
Other capital flows(c)	-18	-25	-9	-2	-7	-5
Official financing balance	-13	10	8	—	3	-1
of which:						
Use of IMF credit	4	1	—	—	—	—
Liabilities to other CMIs	1	—	—	—	—	—
Reserves etc (increase -)	-18	9	8	-1	2	-1

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

### Identified deployment of oil exporters' funds<sup>(a)</sup>

\$ billions

	Dec. 1984 levels	1985				Dec. 1985 levels	1986 Q1(b)
		Q1	Q2	Q3	Q4		
<b>Industrial countries</b>							
United Kingdom:							
Sterling bank deposits	4.6	—	0.1	0.1	0.4	6.4	0.1
Eurocurrency bank deposits	41.2	-0.1	2.3	-1.2	0.1	43.7	-2.0
Government paper	2.2	-0.1	0.3	-0.1	0.4	3.3	0.3
Other investments	5.4	-0.1	0.1	-0.1	-0.2	7.0	—
	53.4	-0.3	2.8	-1.3	0.7	60.4	-1.6
Other EEC(c)							
Domestic currency bank deposits	3.5	-0.3	0.3	—	-0.3	4.1	..
Eurocurrency bank deposits	20.3	1.1	-0.4	0.1	1.6	23.7	..
Other investments	30.1	0.5	-0.1	-0.3	0.4	41.9	..
	53.9	1.3	-0.2	-0.2	1.7	69.7	..
United States:							
Bank deposits	21.2	-0.1	-0.8	1.2	0.1	21.7	0.6
Government paper	31.2	0.2	0.1	-2.2	0.1	29.5	—
Other investments	31.0	-0.5	-1.3	-0.8	-0.4	28.0	0.2
	83.4	-0.4	-2.0	-1.8	-0.2	79.2	0.8
Other:							
Domestic currency bank deposits	3.4	-0.5	0.1	0.4	0.7	4.7	..
Eurocurrency bank deposits	26.9	0.5	1.3	0.3	—	29.4	..
Other investments	39.8	-1.5	-0.3	-3.2	-1.8 <sup>(b)</sup>	37.1	..
	70.1	-1.5	1.1	-2.5	-1.1	71.2	..
Offshore centres:							
Bank deposits	42.3	0.2	-4.8	1.1	2.9	41.7	..
Placements with Idcs	59.4	—	-0.5	—	—	58.8	..
OECD credit to non-banks	7.6	0.1	0.6	-0.1	-0.1	8.1	..
IMF and IBRD(d)	32.4	0.4	0.1	0.7	0.2	34.5	..
<b>Total identified additions(+)/reductions (-) in deployed assets</b>	<b>402.5</b>	<b>-0.2</b>	<b>-2.9</b>	<b>-4.1</b>	<b>4.1</b>	<b>423.6</b>	<b>..</b>
Net funds available for deployment		-0.5	-0.2	-2.9	-3.2		
of which:							
Net movements in external borrowing etc		-0.4	0.6	-1.4	-0.9		
Current balance		-0.1	-0.8	-1.5	-2.3		

.. not available.

- (a) The oil exporting countries covered are defined in the statistical annex in the additional notes to Table 16 in the March 1986 *Bulletin*.  
 (b) Provisional.  
 (c) Includes Spain and Portugal.  
 (d) Includes holdings of gold.

Identified assets of *oil exporting countries* rose by \$4.1 billion in the fourth quarter, despite an estimated increase in the current account deficit over the period and net repayment of external borrowing; there was an increase in bank deposits of \$5.5 billion (more than half of which was in offshore centres) with some continuing liquidation of longer-term investments. Provisional figures for the deployment of funds in the United Kingdom and the United States in the first quarter of 1986 indicate a fall of \$1.3 billion in bank deposits (mainly in the United Kingdom) and an increase of \$0.5 billion in other investments.

### International capital markets

Activity in the international capital markets reached record levels during the three months to May. This was entirely accounted for by a continuing high level of new issues in the fixed-rate bond markets. Unfavourable market conditions, and the popularity of alternative forms of borrowing, meant that issues of FRNs remained at a low level. Euronote announcements rose and there was a further shift in the balance of new issues towards non-underwritten facilities.



## Net flows in the international bond markets

Higher volumes of new bond issues in the international capital markets in 1985 were partly offset by higher repayments. These consisted of both scheduled repayments of bonds at maturity and under sinking funds and early repayments as borrowers called bonds before maturity. In 1985 some \$12 billion of floating-rate notes were called before maturity, with the result that the new funds raised net of repayments were only 75% of the gross new issues (Table A).

**Table A**  
International bond issues: breakdown by instrument  
\$ billions

		1984	1985
Floating-rate notes	Gross	34.1	55.3
	Net	32.2	42.4
Fixed-rate bonds	Gross	74.0	107.4
	Net	57.5	89.1
Total	Gross	108.1	162.7
	Net	89.7	131.5

Table B gives Bank of England estimates for net bond and FRN issues broken down by nationality of issuer.<sup>(1)</sup> Latin American countries, which have not been able to raise new funds from the international bond markets since 1982, made net repayments in 1984 and 1985 as existing bonds matured. Other developing countries, however, increased their net international bond issues. Some nationalities which had been large issuers of FRNs in earlier years called significant numbers of issues during 1985; in some cases as a result they made net repayments under FRNs (Table C).

**Table C**  
Floating-rate note issues for selected nationalities of issuer  
\$ billions

		1984	1985
France	Gross	5.0	6.9
	Net	4.7	2.7
Sweden	Gross	4.1	2.2
	Net	3.9	-0.9
Denmark	Gross	1.7	0.6
	Net	1.7	-0.3

(1) Nationality is defined as country of incorporation, unless an issue is guaranteed by the issuer's parent, in which case it is the parent's country of incorporation.

**Table B**  
Net international bond issues:  
breakdown by nationality of issuer  
\$ billions

	1984	1985
BIS reporting area	72.7	103.6
<i>of which:</i>		
United States	21.5	36.3
Japan	15.0	18.7
United Kingdom	4.0	12.9
Canada	4.3	6.8
France	7.0	6.4
Italy	3.1	5.0
Germany	1.9	2.6
Belgium	1.6	2.1
Norway	0.2	1.8
Sweden	5.3	1.7
Denmark	2.8	1.7
Netherlands	0.8	1.6
Other developed countries	4.7	8.3
<i>of which:</i>		
Australia	2.6	5.1
New Zealand	1.0	1.4
Greece	0.2	0.7
South Africa	0.7	0.6
Eastern Europe	0.1	0.3
<i>of which:</i>		
Hungary	0.1	0.3
OPEC developing countries	—	0.4
<i>of which:</i>		
Algeria	-0.1	0.4
Venezuela	-0.3	-0.1
Saudi Arabia	0.2	—
Other developing countries	1.1	4.5
<i>of which:</i>		
Latin America	-0.8	-0.8
Asia	2.1	5.3
<i>of which:</i>		
Malaysia	1.1	2.0
South Korea	0.7	1.4
Thailand	0.1	0.9
China	0.1	0.8
Other countries	0.1	1.2
<i>of which:</i>		
Hong Kong	0.1	0.9
International institutions	10.9	13.3
<b>Total</b>	<b>89.7</b>	<b>131.5</b>

These estimates of net international bond issues were prepared by the Bank of England using its own database for new issues and for maturing privately-placed bonds. Sinking funds, maturities and early repayments of public bond issues are estimated from data collected by the Association of International Bond Dealers and other sources.

### Fixed-rate bonds

There was a rally in the bond markets during the six months to the end of April in response to, among other forces, expectations of long-term declines in inflation and nominal interest rates, and the impact of falling oil prices on corporate profitability. As a result, yields on long-term bonds declined and yield curves tended to flatten. The yield on 10-year US Treasury bonds fell from 9.9% at the end of October to 7.3% at the end of April, although there was a subsequent rise to 8.0% at the end of May as the

general rally in the bond markets came to an end. For borrowers, fixed-rate funds become more attractive the nearer yields are presumed to be to the trough of the cycle and during the three months to May there was a record volume of new fixed-rate issues in the international bond markets, totalling \$52.5 billion. This represented an increase of 43% over the previous three months. After allowance for a seasonal increase during March and April the average monthly volume of new bond issues was 95% higher than the monthly average for 1985 as a whole.



The increase in the three months to May has been concentrated among industrialised countries, with borrowers from North America, Japan and Western Europe accounting for 86% of new issues, compared with 76% during the three months to February. US borrowers raised \$11.8 billion, mainly reflecting increased activity by industrial corporations, which accounted for 82% of this total. Borrowing by developing countries totalled \$593 million, compared with \$860 million during the preceding three-month period. This was entirely composed of \$390 million raised by Chinese borrowers and \$203 million for South Korean borrowers.

Sovereign borrowers have continued to be active issuers of fixed-rate bonds, raising \$4.2 billion in the three months to May. A number of countries which were prominent borrowers in the FRN market, notably Sweden, Denmark and Belgium, have switched to raising funds through fixed-rate bond issues which are subsequently swapped to obtain floating-rate funds.

The proportion of issues denominated in dollars was 48% compared with 51% in the preceding three months. Other currencies moved more erratically, with the yen's share of new issues, for instance, being equivalent to 21% of total borrowing in March but only 4% in April and 11% in May. Swap opportunities appear to be an important determinant of the volume of new issues both in yen and in some less widely traded currencies. During March sterling borrowing accounted for 11% of new issues and at least 40% of these were subsequently swapped. A similar trend was evident in borrowing denominated in ECU which increased during April following the realignment of EMS currencies. At least 50% of new ECU-denominated issues were swapped and these opportunities, combined with greater certainty over exchange values following the realignment, led to 8% of new issues in April being denominated in ECU. The currency with the highest proportion of swap-related

deals remains the Australian dollar, where a minimum of 50%–60% of new issues during the three months to May were swapped.

Options incorporated in bond issues have increasingly become a focus for innovation. Further nuances have been developed on the dual-currency technique which has been used most widely in the euromarket. These issues provide longer-dated options on the yen-dollar exchange rate. Further refinements have also taken place on the indexed currency option notes (ICONS) formula, introduced in the fourth quarter of 1985, where the redemption value of the principal of the bond issue is determined by the level of the yen/dollar exchange rate at maturity in relation to a pre-set break-even point. During the three months to May a parallel formula was developed, to provide an interest rate option equivalent, with the redemption amount indexed to US Treasury bond yields.

Equity-related issues (convertibles and equity warrants) amounted to \$6.3 billion in the three months to May, compared with \$4.8 billion during the preceding three months. The popularity of equity-related issues reflects the longer-term rise in stock prices on almost all of the world's leading exchanges and there has been a strong demand for equity options in the form of warrants where investors have expectations that the actual rise in stock prices will exceed the margins built into the option price.

Attempts have been made to adapt the medium-term note programme formula, which has been employed for some time in the US domestic market, for international usage. These facilities allow borrowers to issue notes continuously with maturities typically in the range of 1–15 years. The result is a hybrid structure combining techniques of the commercial paper markets and those for issuing medium-term bonds. So far, two programmes have been arranged by foreign borrowers in the US markets, including an issue for the IBRD which had a maturity range of 3–30 years, as well as two issues in the euromarkets for facilities totalling \$350 million. At present these programmes are not incorporated in the totals for international borrowing given here.

#### Floating-rate notes

FRN issues announced in the three months to May totalled \$6.1 billion, \$2.1 billion less than in the preceding three months. The monthly average was 44% lower than the average for 1985 as a whole. Average spreads over Libor have tended to rise, a feature which commonly accompanies a decline in the volume of new issues.

Sovereign borrowing and borrowing by financial institutions have continued to comprise the largest share of new issues—84% during the three months to May—and in both cases new borrowing in the FRN market has declined. US banks have previously been one of the largest groups of borrowers and during the three months to May they issued only \$550 million of FRNs, compared with a quarterly average of \$2.44 billion during 1985. This reflected an oversupply of unsold notes accumulated in

#### Announced international bond issues<sup>(a)</sup>

\$ billions; percentages in italics

	1984		1985		1986		
	Year	Year	Q3	Q4	Q1	Apr.	May
<b>Fixed-coupon bonds</b>							
Borrower:							
Major OECD countries	46.8	70.5	18.3	20.1	31.9	17.6	9.9
of which:							
United States	20.0	30.2	8.4	9.0	11.4	5.9	2.3
Japan	14.4	19.0	4.6	4.1	5.7	3.6	2.9
Minor OECD countries	12.8	18.4	3.7	5.6	9.5	3.3	2.6
International institutions	12.4	15.7	5.1	4.1	5.3	1.0	1.1
Other	2.0	2.8	0.8	0.4	0.9	0.3	0.2
<b>Total</b>	<b>74.0</b>	<b>107.4</b>	<b>27.9</b>	<b>30.2</b>	<b>47.6</b>	<b>22.2</b>	<b>13.8</b>
Currency:							
US dollars	50.1	46.8	42.9	44.9	47.2	49.5	55.1
Swiss francs	17.4	13.7	11.2	18.2	12.6	11.7	6.7
Yen	8.0	11.3	13.9	11.5	15.9	4.1	10.2
Other	24.5	28.2	32.0	25.4	24.3	34.7	28.0
<b>Floating-rate notes</b>							
Borrower:							
Major OECD	21.6	38.6	7.1	11.5	5.4	2.1	1.1
Minor OECD	9.6	8.1	1.1	1.1	1.6	0.4	0.7
Other	2.8	8.6	1.5	1.8	1.4	—	0.1
<b>Total</b>	<b>34.0</b>	<b>55.3</b>	<b>9.7</b>	<b>14.4</b>	<b>8.4</b>	<b>2.5</b>	<b>1.9</b>

(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.



the inventories of lead managers, following the large volume of borrowing in the fourth quarter of 1985, and increased fears of credit risks in the loan portfolios of a number of US banks which had previously been active borrowers. New issues of FRNs by UK financial institutions totalled only \$1.5 billion. There was a decline in new perpetual primary capital FRN issues by banks, and building societies raised only £500 million after an initial spate of issues following the opening up of the market to these borrowers.

Three sovereign issues were announced, totalling \$800 million, including a \$250 million conduit issue designed to refinance Hungarian foreign trade credits. The Hungarian issue employed a novel defeasance procedure, with the FRN issue collateralised by a matching portfolio of zero-coupon US Treasury bonds.

The proportion of FRNs denominated in dollars continued to decline, averaging 69% in the three months to May, compared with 87% during 1985 as a whole. Sterling issues accounted for 24% (£975 million) of new issues, mainly reflecting the preponderance of sterling-denominated issues in UK borrowing. In currencies where recent deregulation has enabled FRNs to be issued for the first time, there were no new issues denominated in yen or Dutch guilders, and only DM 150 million in deutschemark.

After allowance for maturing issues and exercising of call options, total net new borrowing in the FRN market during the three months to May is likely to have been small. French borrowers were prominent in calling outstanding FRNs, reflecting a strong net inflow of funds following the realignment of the French franc within the EMS. The EEC is also calling a \$1.8 billion FRN issue, the proceeds of which had been onlent to France under the Community Loan Mechanism.

### 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.*

The total value of euronote facilities announced in the three months to May rose \$3 billion from the previous three months' total to \$18.6 billion. The proportion of facilities which are non-underwritten or uncommitted (commonly known as eurocommercial paper programmes) was 70% (by value) compared with 33% in 1985.

Borrowers continue to be almost exclusively from OECD countries. Facilities for Japanese borrowers, who made little use of the market before 1986, increased markedly to \$5 billion in the three months to May. Most of the Japanese facilities were for banks, although it is noteworthy that the larger City banks have not entered the market. Part of the explanation for the increase in Japanese activity in the market may lie in the possibility for trust banks, smaller City banks and long-term credit

### Announced euronote facilities<sup>(a)</sup>

\$ billions

	1984	1985	1986				
	Year	Year	Q3	Q4	Q1	Apr.	May
Committed <sup>(b)</sup>	18.20	33.14	5.01	8.50	3.41	2.03	3.03
Uncommitted	0.64	16.35	2.96	9.80	10.70	4.06	5.61
<b>Total</b>	<b>18.84</b>	<b>49.49</b>	<b>7.97</b>	<b>18.30</b>	<b>14.11</b>	<b>6.09</b>	<b>8.64</b>
<i>of which:</i>							
Major OECD	6.40	29.26	4.22	10.66	8.08	4.10	5.82
Minor OECD	11.20	17.55	3.34	6.93	5.43	1.92	2.77
Other	1.24	2.68	0.41	0.71	0.60	0.07	0.05
<b>Selected nationalities of borrower</b>							
United States	3.16	17.48	1.84	5.88	2.05	1.48	2.80
France	1.24	2.99	0.58	0.70	1.35	0.20	0.34
United Kingdom	0.72	3.82	1.00	1.92	1.48	1.18	0.20
Australia	2.72	7.90	1.68	3.96	1.17	0.35	0.80
Sweden	4.72	4.82	1.20	0.32	1.25	0.25	0.30

(a) Includes all facilities providing for the issue of euronotes (including note issuance facilities, revolving underwriting facilities, multiple component facilities which incorporate a note issuance option, and eurocommercial paper programmes).

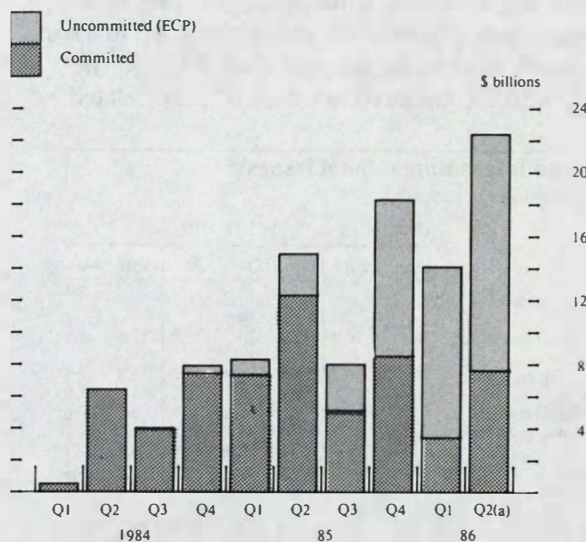
(b) Underwritten or otherwise backed by bank commitments.

banks of lowering their funding costs by this method of distribution.

Among the other developed countries (most of whose facilities are uncommitted), the total for US borrowers has remained high, at \$4.2 billion. UK borrowers have also continued to be active. A \$500 million facility has been arranged for Spain with an annual facility fee (as low as the market has yet seen) of five basis points, replacing a previous \$500 million facility which was arranged in 1984 but never used. Only two facilities were arranged for non-OECD borrowers.

A new type of facility has been arranged by the Nordic Investment Bank: a \$400 million facility consisting of a \$200 million ECP programme and a \$200 million euro medium-term note programme (described above).

### Euronote facilities



(a) April/May at quarterly rate.

### Eurocurrency syndicated lending

Borrowing in the syndicated credits market continued to be slightly higher than in 1985, with a total value of \$6.4 billion in the three months to May, but remains small in comparison with the other sectors of the international capital markets.



**Announced eurocurrency syndicated credits**

\$ billions

	1984		1985		1986		
	Year	Year	Q3	Q4	Q1	Apr.	May
Major OECD	9.90	5.06	1.10	1.40	2.21	0.57	0.82
Minor OECD	6.16	4.40	0.86	0.49	1.11	0.51	0.20
Developing countries	7.17	3.92	1.29	0.08	1.25	0.02	0.50
Eastern bloc	2.19	3.55	0.71	0.46	0.50	0.78	0.10
Other	4.69	1.99	0.54	0.70	1.66	0.36	0.79
<b>Total</b>	<b>30.11</b>	<b>18.92</b>	<b>4.50</b>	<b>3.13</b>	<b>6.73</b>	<b>2.24</b>	<b>2.41</b>
<i>of which, transferable</i>	<i>1.49</i>	<i>5.77</i>	<i>1.62</i>	<i>1.55</i>	<i>1.75</i>	<i>0.30</i>	<i>0.75</i>

The terms on which most OECD borrowers have been able to obtain credits have generally continued to improve. A new benchmark low facility fee has been set for EdF, France's electricity utility, with a \$600 million loan facility carrying an annual commitment fee of four basis points for the first three years, rising to five points for the subsequent seven.

Borrowers in some minor OECD countries, however, have not found borrowing cheaper—notably Greece and Turkey. The more recent of two loans for Turkish borrowers carried a spread of 1½% over Libor, comparable to the interest rates on the most recent reschedulings by commercial banks for debtor countries.

Following the collapse of oil prices, oil-exporting countries have increased their borrowings. There have been sizable new loans for Oman (\$500 million), Abu Dhabi Gas Liquefaction Company (\$650 million) and for an Algerian borrower, Banque de l'Agriculture et du Developpement Rural (\$300 million). This last loan was the second for an Algerian financial institution in 1986, and it saw a widening of terms over the first. A \$75 million credit for Gabon also showed an increase in the spread compared with their last borrowing, in 1985.

Eastern bloc borrowers have continued to be active in the market, with new loans for Hungary, the USSR and Czechoslovakia—in Hungary's case, with a marked improvement in terms compared with its last loan in 1985.

Among non-oil developing countries, only India, Pakistan, Tunisia, Bermuda and South Korea have raised new market loans. There has been a series of five credits for Chinese borrowers, raising \$300 million.

**International banking developments**

*This section focuses on developments in the international business of banks in the BIS reporting area in the fourth quarter of 1985 and, separately, of banks in the United Kingdom in the first quarter of 1986.*

**Banks in the BIS reporting area (fourth quarter of 1985)**

There was exceptional growth in BIS-area banks' cross-border lending in the fourth quarter. Indeed, the rise was greater than in the first three quarters of 1985 added together. This record increase was largely the result of an expansion in interbank business within the reporting area. There were two main sources of growth: first, Italian and German banks expanded their business, with rises

which, although partly seasonal, were higher than in the fourth quarter of 1984; and second, there was record growth in the cross-border lending of Japanese banks in a quarter when, for these banks, the seasonal pattern is a contraction.

The upturn recorded in the third quarter in the growth of estimated lending to final users (a measure which includes all cross-border lending and foreign currency claims on residents) accelerated in the final quarter. The rate of growth in 1985 as a whole, however, at around 8%, was only marginally higher than in 1984. Three quarters of the latest rise represented lending to final users within the reporting area, with the United Kingdom and the United States absorbing half these funds. A substantial part of the expansion in lending to final users within the reporting area took the form of banks' purchases of securities.

Lending to outside-area countries showed the largest quarterly rise for two years, although the rate of growth in 1985 as a whole remained low, at just over 3%. Banks continued to be selective in their new 'spontaneous' lending: China, the Soviet Union, Australia, South Korea and India were the largest individual borrowers. Argentina and Chile made drawings of new 'package' money in the final quarter.

Outside-area countries increased their deposits with BIS-area banks in the fourth quarter by more than their borrowing, so that they were modest net suppliers of funds to the international banking markets, in contrast to the position for the year as a whole. Oil exporting countries were the main suppliers of funds in the final quarter.

There was strong growth in loans denominated in currencies other than the dollar in the fourth quarter, with the yen, deutschemark, Swiss franc and, to a lesser

**Cross-border business of banks in the BIS reporting area**

\$ billions; changes exclude estimated exchange rate effects

	1983			1984			1985			Out-standing at end-Dec. 1985
	Year	Year	Year	Q2	Q3	Q4	Q2	Q3	Q4	
<b>Deposits from</b>										
Outside reporting area:										
Developed countries	+ 2	+ 3	+ 3	+2	+ 2	—				35
Eastern Europe	+ 3	+ 4	+ 3	+2	+ 2	+ 2				27
Oil exporting countries	- 14	+ 2	+ 7	-1	+ 2	+ 5				160
Non-oil developing countries	+ 10	+ 20	+ 3	—	—	+ 4				177
<i>of which, Latin America</i>	+ 6	+ 10	- 1	—	- 1	- 4				68
Sub-total	+ 1	+ 30	+ 16	+3	+ 6	+ 11				399
Inside reporting area(a)	+105	+119	+213	-4	+44	+112				2,019
Unallocated	+ 4	- 1	+ 1	-2	+ 5	—				59
<b>Total</b>	<b>+111</b>	<b>+148</b>	<b>+231</b>	<b>-4</b>	<b>+55</b>	<b>+123</b>				<b>2,476</b>
<b>Lending to</b>										
Outside reporting area:										
Developed countries	+ 7	+ 6	+ 6	+2	+ 1	+ 2				100
Eastern Europe	- 1	—	+ 5	+3	+ 2	+ 1				60
Oil exporting countries	+ 10	- 2	- 1	-2	—	+ 1				110
Non-oil developing countries	+ 12	+ 10	+ 9	+3	+ 2	+ 5				350
<i>of which, Latin America</i>	+ 8	+ 6	+ 1	—	- 1	+ 2				218
Sub-total	+ 28	+ 14	+ 19	+6	+ 5	+ 10				620
Inside reporting area(a)	+ 74	+109	+199	-1	+30	+114				1,841
Unallocated	+ 4	—	+ 4	+2	—	+ 1				51
<b>Total</b>	<b>+106</b>	<b>+123</b>	<b>+222</b>	<b>+7</b>	<b>+35</b>	<b>+124</b>				<b>2,513</b>

(a) Including non-reporting 'offshore' centres.



extent, ECU, particularly popular. An analysis of the stock of cross-border claims at the end of 1985 shows that the yen has for the first time overtaken the Swiss franc in importance. Nevertheless, yen loans still account for only 6% of total external lending, a contribution some way behind the deutschemark (12%) and US dollar (63%).

### The London market (first quarter of 1986)

The strong growth in cross-border lending recorded in the second half of 1985 continued in the first quarter of 1986. Most of the increase in the first quarter represented interbank lending within the BIS reporting area, mainly to banks in Japan and the United States. The rate of securitised lending, however, slowed in the quarter.

Whereas non-banks in the BIS reporting area were significant net suppliers of funds to the London euromarkets in the first quarter, banks in the reporting area were net takers by an equal amount. Both the United States and Japan were significant net takers of funds. In the case of Japan, the position was entirely on account of interbank operations, with head offices using their London branches to raise eurofunds. For the United States, while non-banks were modest net depositors with banks in London, banks in the United States ran down their interbank deposits and increased their borrowing and consequently absorbed over \$8 billion from London. West Germany stood out as the largest supplier of funds in the quarter.

In contrast to the previous three quarters, there was a reduction in claims on countries outside the BIS reporting area, particularly on oil exporting countries and non-oil developing countries. The reduction in claims on Latin America was accounted for by Mexico, who also increased

their bank deposits and, overall, were net depositors in London of over \$1 billion in the quarter. Surprisingly, the largest single fall in lending was to China, which in recent periods has become one of the most significant borrowers from BIS-area banks among the developing countries. The small increase in UK banks' lending to developed countries outside the BIS reporting area was mainly accounted for by new lending to Australia. Lending to Eastern European borrowers moderated somewhat in the first quarter, with the Soviet Union the most active borrower.

Countries outside the reporting area also reduced their deposits with banks in the United Kingdom in the first quarter. The largest fall was by the oil exporting countries, particularly those in the Middle East, as they adjusted their liquid balances in response to the decline in export revenues. Within the non-oil developing countries group, China and Malaysia showed the largest falls in deposits.

### Foreign exchange and gold markets

*This section reviews the three months to end-May.*

The European Monetary System (EMS) experienced increased tension at the start of the period under review and, in early April, central rates were realigned: the principal changes were a 3% revaluation of the deutschemark and the Dutch guilder, and a 3% devaluation of the French franc. The downward trend in the dollar since last September was not sustained. In March, the dollar rallied strongly on reports of market purchases by major central banks which led to market expectations that some members of the Group of Five industrial countries (the G5) would act in concert to moderate or halt temporarily the further appreciation of their currencies against the dollar. The dollar briefly fell back as indicators suggested a slower rate of US economic activity, US interest rates eased and expectations of concerted official support for the dollar were disappointed by the outcome of the Tokyo Economic Summit. New recent lows against the deutschemark and all-time lows against the yen were recorded before the dollar rallied again. Sterling firmed over the period as a whole, influenced in part by the relatively high level of UK real interest rates and generally firmer oil prices, and recorded its highest level against the dollar for almost three years, but fell back temporarily against Continental currencies following the re-emergence of rumours that the pound was poised to join the exchange rate mechanism of the EMS.

### Sterling

Sterling opened the period on 3 March at ERI 72.4, \$1.4375 and DM 3.1963 in London. It briefly continued the fall seen at the end of February in response to weakening oil prices, to touch a low for the period of \$1.4325 and an all-time low of DM 3.1825, before rallying on a recovery in oil prices. As the United Kingdom did not immediately join the round of interest rate cuts announced on 6 and 7 March in other financial centres, sterling benefited from capital inflows, which became

### Cross-border business of banks in the United Kingdom

\$ billions; changes exclude estimated exchange rate effects

	1984	1985				1986
	Year	Year	Q2	Q3	Q4	Q1
<b>Deposits from:</b>						
BIS reporting area(a)	+25.3	+40.9	—	+13.2	+15.7	+10.9
'Offshore' banking centres(b)	+ 6.8	+ 5.2	+0.6	+ 1.1	+ 0.2	+ 1.5
Sub-total	+32.1	+46.1	+0.6	+14.3	+15.9	+12.4
Developed countries	+ 1.4	+ 1.4	+0.5	+ 1.2	- 0.6	- 0.3
Eastern Europe	+ 0.9	+ 1.3	+0.7	+ 0.7	+ 0.7	- 0.3
Oil exporting countries	- 1.2	+ 1.8	+2.4	- 1.1	+ 0.5	- 1.9
Non-oil developing countries	+ 4.8	- 1.0	+0.1	- 1.6	+ 1.1	- 1.0
of which, Latin America	+ 2.9	- 2.2	-0.7	- 0.5	- 0.8	+ 0.6
Sub-total	+ 5.9	+ 3.5	+3.7	- 0.8	+ 1.7	- 3.5
Others	- 1.8	- 0.7	—	- 0.1	- 0.5	+ 0.6
<b>Total</b>	<b>+36.2</b>	<b>+48.9</b>	<b>+4.3</b>	<b>+13.4</b>	<b>+17.1</b>	<b>+ 9.5</b>
<b>Lending(c) to:</b>						
BIS reporting area(a)	+16.0	+30.1	-4.7	+14.3	+11.0	+15.7
'Offshore' banking centres(b)	+ 9.3	- 4.4	+1.4	- 3.7	- 2.3	+ 0.4
Sub-total	+25.3	+25.7	+3.3	+10.6	+ 8.7	+16.1
Developed countries	+ 1.2	+ 2.3	+0.4	—	+ 1.4	+ 0.3
Eastern Europe	- 0.4	+ 3.3	+1.1	+ 1.3	+ 1.0	+ 0.3
Oil exporting countries	- 1.0	- 0.5	-0.3	- 0.5	+ 0.2	- 0.7
Non-oil developing countries	+ 1.1	+ 2.9	+1.0	+ 1.9	+ 0.8	- 1.9
of which, Latin America	+ 1.9	+ 1.5	+0.1	+ 1.8	- 0.1	- 0.2
Sub-total	+ 0.8	+ 8.0	+2.2	+ 2.7	+ 3.4	- 2.0
Others	- 0.8	- 1.1	+0.1	—	- 1.2	+ 0.2
<b>Total</b>	<b>+25.3</b>	<b>+32.6</b>	<b>-1.0</b>	<b>+13.3</b>	<b>+10.9</b>	<b>14.3</b>

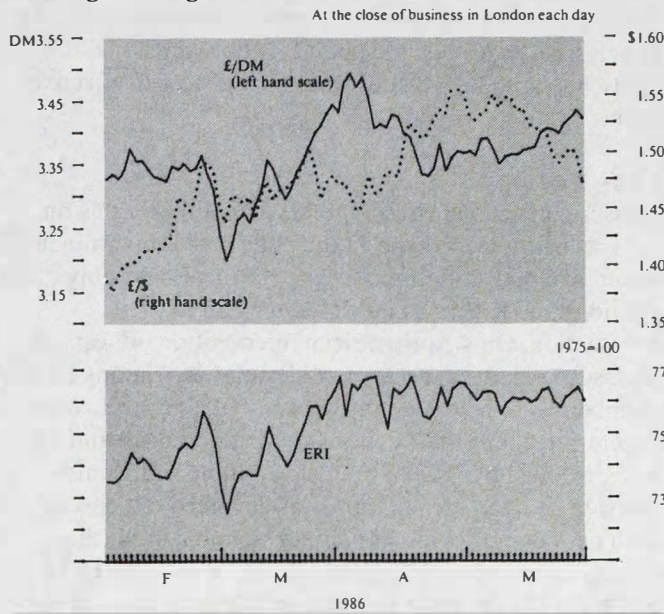
(a) Excluding 'offshore' reporters.

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

(c) 'Securitised' lending is included only from the first quarter of 1986.



## Sterling exchange rates



heavy following the favourable reception given to the Budget. On 24 March, sterling reached ERI 76.9 and DM 3.45 in London and \$1.5190 in New York. Sterling's progress was at times affected by developments in the oil market in response to news from the OPEC conference and, in particular, to the adjournment of OPEC's discussions on 24 March without agreement on production limits. Oil prices fell sharply in reaction and sterling moved down to touch \$1.4570 and DM 3.3853 on 25 March, although it soon recovered its buoyant tone to finish the month at ERI 76.3, \$1.4780 and DM 3.4437.

Sterling's underlying firmness continued into the first week of April, even though oil prices fell below \$10 per barrel, as UK real interest rates remained at relatively high levels. Oil prices then recovered in response to a strike on Norwegian oil rigs and official statements from the United States about the need for stability in oil prices. The  $\frac{1}{2}$ % cut in UK clearing banks' base rates (to 11%) on 8 April had little effect on the pound. Following the EMS realignment, however, renewed rumours circulated that sterling was about to join the exchange rate mechanism and, with oil prices again weakening and UK interbank interest rates easing, the pound lost its buoyant tone against Continental currencies, although it improved against the weakening dollar. The inconclusive outcome of the readjoined OPEC meeting and further EMS rumours took sterling down to DM 3.3217 on 22 April before renewed oil price optimism encouraged a recovery against Continental currencies and took sterling to a 34-month high of \$1.5590 in New York on 29 April. Sterling finished the month at ERI 76.5, \$1.5535 and DM 3.3664.

With holidays in various financial centres in early May and the approach of the Tokyo Economic Summit scheduled for 4-6 May, sterling saw only modest business and moved onto the sidelines. During the remainder

of the month, the pound eased back against the strengthening dollar but continued to recover ground against Continental currencies. It finished the period at ERI 76.0 (+3 $\frac{7}{8}$ % over the period), \$1.4725 (+1 $\frac{1}{2}$ %) and DM 3.4221 (+5 $\frac{3}{4}$ %).

## Official reserves

Over the three months to end-May, there was an underlying increase in UK reserves of \$680 million. Net public sector borrowing under the exchange cover scheme totalled \$230 million, while \$33 million was repaid in respect of bonds issued in New York by HM Government. The reserves fell by \$8 million on account of the valuation adjustment arising from the quarterly roll-over of the European Monetary Co-operation Fund swap. The effect of the annual revaluation of the reserves at end-March was to increase their dollar value by \$2,505 million, comprising an increase of \$592 million on gold and \$1,913 million on SDR-denominated assets, ECUs and non-dollar currencies. At the end of May, the reserves stood at \$19,166 million.

## Changes in UK official reserves

\$ millions

	1986				
	Jan.	Feb.	Mar.	Apr.	May
Change in reserves	+ 17	+250	+ 435	+237	+179
of which:					
Net borrowing (+)/payment (-) of public debt	+ 63	+138	+ 157	- 19	+ 41
Valuation change on roll-over of EMCF swap	-178	—	—	- 8	—
Underlying change in reserves	+132	+112	+ 278	+264	+138
Annual revaluation of reserves	—	—	+2,505	—	—
Level of reserves (end of period)	15,560	15,810	18,750(a)	18,987	19,166

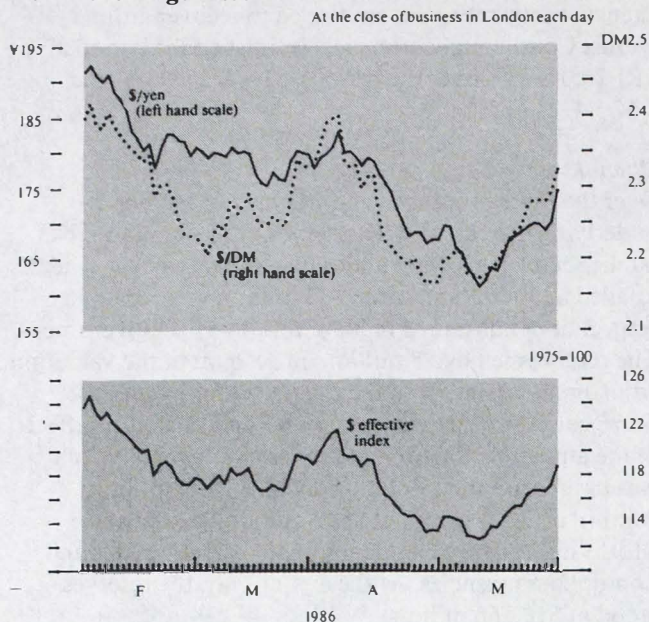
(a) After the annual revaluation.

## US dollar

Over the period, the dollar fluctuated without trend, principally in response to shifts in the balance between two conflicting influences on market sentiment. On the one hand, there were continuing doubts about the performance of the US economy. In addition, expectations arose of lower US interest rates as market participants judged that the Federal Reserve would relax monetary policy in order to revive and sustain activity, as well as to aid US financial institutions by ameliorating the servicing burden on their oil-dependent debtors, domestic and foreign. On the other hand, the belief also emerged among market participants that, within the framework of G5 co-operation, the Federal Reserve might concert with the Bank of Japan and the Bundesbank to stabilise the dollar. Specifically, reports of dollar purchases by the Bank of Japan as the dollar fell toward ¥174, followed by a statement from a Bank of Japan official that the Bank of Japan and the Federal Reserve believed that the adjustment of the dollar was more or less complete, initiated a strong rally, which for a time took the dollar clear of the trend established since last September. The dollar may also have benefited briefly from a move into US financial markets in search of a 'safe haven' following the US retaliatory action against Libya. The dollar reached its peak following the EMS realignment, as speculative holdings of deutschmarks were unwound and on



## Dollar exchange rates



expectations that the G5 meeting to be held in the margins of the International Monetary Fund's Interim Committee might agree on concerted support for the dollar. Highs of DM 2.4157 and ¥183.15 were reached on 7 April.

Expectations of a further cut in the US discount rate then resurfaced and the dollar fell back. The dollar eased further following the release of weak US economic indicators and accommodative Federal Reserve intervention in the domestic money markets which preceded a  $\frac{1}{2}$ % cut (to  $6\frac{1}{2}$ %) in its discount rate announced on 18 April (which was followed in Japan). Statements from President Reagan and Treasury Secretary Baker approving the dollar's depreciation contributed to further falls in the dollar. Further reported market purchases of dollars by the Bank of Japan and the Bundesbank ahead of the Tokyo Economic Summit revived market fears of concerted central bank action in support of the dollar but, as the market concluded that the Summit agreement did not extend to specific exchange rate action, the dollar again eased. This erratic fluctuation continued in response to further conflicting statements by officials from G5 countries, with the dollar touching a new all-time low of ¥159.90 in the Far East on 12 May.

Following US Treasury Secretary Baker's appearance on 13 May before a US Senate sub-committee, in which he expressed concern that the dollar had fallen too rapidly, the dollar recovered strongly. Support was received from reports of further official intervention by the Bank of Japan, firmer US interest rates in the wake of the unexpected surge in M1 (+\$6.1 billion in the week ending on 5 May) and a strong outturn for US GNP growth in the first quarter of 1986 (+3.7%). The dollar reached DM 2.3255 and ¥174.55 on 30 May, helped by reports of further official intervention in New York, before closing the period at DM 2.3240 (+4% over the period), ¥174.45 (-3%) and 118.7 (1985=100) in effective terms (+3%).

From the close of business in New York just before the G5 meeting last September up to the end of May, the dollar lost 7% against the pound, 18% against the deutschmark, 26% against the yen and 15% in effective terms.

## EMS

Pressure intensified within the EMS, mainly bearing on the French franc, on expectations that a new government would win power in France at the National Assembly elections on 18 March and would seek an early devaluation. On 4 April, official intervention obligations were suspended for the day and negotiations among EMS members were held over the weekend of 5-6 April. With effect from 7 April, the deutschmark and Dutch guilder were revalued by 3% and the Belgian franc and Danish krone by 1%; the French franc was devalued by 3%; the Irish pound and Italian lira remained unchanged (these changes being relative to bilateral central rates against a selected EMS currency, in this case, the lira).

Following the realignment, there were heavy capital reflows from Germany to France as speculative positions were unwound. The French franc rose to the top of the narrow band and the deutschmark, Dutch guilder and Danish krone fell to the bottom. The size of the capital reflows at times put the system under renewed pressure and the narrow band was at times fully stretched. Pressures were relieved by the easing of the dollar and interest rate reductions by some countries participating in the exchange rate mechanism, although the narrow band remained more than 2% wide. At the end of the period, the narrow band was 2% wide between the French franc and the deutschmark. The Italian lira finished  $\frac{1}{16}$ % below the French franc.

## Other currencies

The yen firmed by 3% over the period to ¥174.45 against the dollar and by 5% in effective terms to 200.3 (1975=100).

The Swiss franc gained 2% against the dollar over the period to finish at Sw.Fc.1.9312 but lost 8% in effective terms to 155.4 (1975=100).

The Norwegian krone came under pressure over the period as the impact of oil price weakness triggered a political crisis leading to a change of government. The krone was devalued over the weekend of 10-11 May by 12% against its trade weighted index. Over the period, the krone lost 11% against the dollar to finish at Nkr7.8150, and 9% in effective terms to finish at 78.8 (1975=100).

## Gold

Gold was generally quiet. The price fell back sharply in early April in reaction to falls in other precious metal prices but recovered, to reach \$347.25 on 23 April, on Far East demand. It finished the period at \$343.20 at the final fixing in London in May, up \$5.05 on the period.