

# International financial developments

Among the main developments:

- The combined current account deficit of the major seven OECD economies is estimated to have contracted further in the third quarter of 1986, largely reflecting increases in the Japanese and German surpluses.
- In the international capital markets, activity in the fixed-rate bond market remained relatively subdued in September and October. The recovery in the FRN sector continued in September, reflecting in particular HM Government's \$4 billion issue, but fell back in October.
- BIS-area banks' cross-border lending rose substantially in the second quarter of 1986, mainly reflecting an unusually large expansion in interbank lending within the reporting area. Outside-area countries, particularly oil exporting countries, which continued to draw down their deposits on a substantial scale, were large net takers of funds from the international banking markets: the Eastern European Bloc was the largest borrower from BIS-area banks in the quarter.
- In the foreign exchange markets, the dollar fluctuated widely in September and October but strengthened overall, by 2% in effective terms. Oil price considerations and bearish sentiment led to renewed pressure on sterling, which fell by more than 5% against the dollar and over 3% in effective terms during the period.

## Balance of payments positions

The combined current account of the *major seven economies* is estimated to have continued to strengthen (to a balanced position) in the third quarter of 1986. The US current account deficit is expected to have been unchanged in the third quarter, although the trade deficit in September was lower than in August, suggesting that trade volume shifts may be beginning to offset the direct impact of currency depreciation on trade prices. In contrast, the Japanese and German surpluses are estimated to have widened, with terms of trade gains outweighing the impact of a more rapid growth of import than of export volumes. An increase in the deficit on net manufacturing trade led to an overall current account deficit for the United Kingdom during the third quarter, while the Canadian current account deficit is estimated to have increased following a steep rise in imports.

The estimate of the combined current account surplus of the *smaller OECD countries* for the third quarter shows an increase from the modest surplus recorded in the previous three months. However, the strengthening of the aggregate external position masks disparate trends, with marked terms of trade gains for net oil and net primary commodity importing countries offsetting the deteriorating performance of those countries more dependent on commodity exports.

The current account deficit of *non-OPEC developing economies* is estimated to have continued to narrow

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

\$ billions; seasonally adjusted

	1984	1985	1985		1986(b)		
	Year	Year	Q3	Q4	Q1	Q2	Q3
OECD economies:							
Canada	3	-2	-1	-1	-2	-1	-3
France	-1	1	-	1	1	-	1
Germany	7	14	4	5	8	8	11
Italy	-3	-4	2	-1	-2	1	2
Japan	35	49	13	15	15	22	26
United Kingdom	1	4	1	1	1	1	-2
United States	-107	-118	-28	-34	-34	-35	-35
Major economies	-65	-56	-9	-14	-13	-4	-
Other OECD	-2	-3	-	-1	-	2	4
Total OECD	-67	-59	-9	-15	-13	-2	4
OPEC economies	-12	-1	-	-3	-7	-10	-11
Non-OPEC developing economies	-18	-27	-6	-6	-7	-6	-4
Other economies(c)	6	5	2	1	-	-	-1
World discrepancy(d)	-91	-82	-13	-23	-27	-18	-12

(a) Components may not add due to rounding.

(b) Includes Bank estimates/forecasts.

(c) The centrally planned economies and South Africa.

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

during the third quarter. This trend reflects further export growth in some of the newly industrialising countries, together with lower net interest payments associated with lower world interest rates. In addition, in many developing countries financing constraints may still be reducing the scope for more than modest import growth.

On a global perspective, provisional estimates suggest that the world current account discrepancy may have more than halved between the first and third quarters of 1986. Timing differences in the recording of trade flows earlier



## Non-OPEC developing countries' balance of payments

\$ billions; not seasonally adjusted

	1984	1985(a)		1986(a)			
	Year	Year	Q2	Q3	Q4	Q1	Q2
<b>Current account</b>	-18	-27	-6	-6	-7	-9	-3
<b>Capital account</b>	31	24	7	5	10	8	5
<i>of which:</i>							
Concessionary and other official flows							
Direct investment	28	18	4	5	5	6	6
Borrowing from banks(b)	8	8	2	2	2	3	2
Borrowing via bond issues (gross)	11	11	4	2	6	-6	-
Other capital flows(c)	3	7	2	1	3	1	1
<b>Official financing balance</b>	-19	-20	-5	-5	-6	-	-4
<i>of which:</i>							
Use of IMF credit	13	-3	1	-1	3	-1	2
Liabilities to other CMIs	4	1	1	-	-	-	-1
Reserves etc (increase -)	1	-	-	-	-	-	-
	-18	2	-2	1	-3	1	-1

(a) Includes Bank estimates.

(b) Adjusted to exclude valuation effects.

(c) Including net errors and omissions.

in the year—world import volume rose by over 6% (seasonally adjusted annual rate) in the first half but exports by only 2%—have probably unwound, thus providing a temporary offset to the underlying discrepancy, which may itself have declined as a result of falls in world interest rates, since unreported investment income is thought to be one of its major components.

Net capital flows to *non-OPEC developing economies* are estimated to have fallen during the second quarter of 1986, although net flows from banks showed no change, following a sharp decline in the previous quarter. Within the unchanged level of borrowing from banks, large draw-downs by Argentina (arranged in connection with an IMF adjustment programme) were offset by several smaller reflows from South Korea, Taiwan, Brazil, Chile and Uruguay.

Estimates suggest a marked deterioration in the combined current account of the *oil exporting countries* and, not surprisingly, their identified assets were reduced, by a further \$2.5 billion, in the second quarter, following a run-down of almost \$5 billion in the first. Bank deposits were reduced generally (down \$7.5 billion overall) as were investments in the United States (down \$1.1 billion), but the bulk of the funds withdrawn were redeployed in investments in other industrial countries (other than the United States) which rose by \$6.0 billion. In dollar terms, the value of the overall stock of deployed assets continued to rise over the year to end-June 1986. This increase was particularly marked among investments in the European Community and other industrial countries, reflecting rises in the value of the currencies of denomination of these assets against the dollar and the oil exporters' ability to respond to these movements.

## International capital markets

In September and October the fixed-rate bond market recovered slightly from the low levels seen in the summer, but volume still fell considerably short of the record totals of the first half of the year. The FRN market continued its summer resurgence into September, notably with the United Kingdom's \$4 billion issue, but activity fell

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

\$ billions

	1985			1986		June 1985 levels	June 1986 levels
	Q2	Q3	Q4	Q1	Q2		
<b>Industrial countries</b>							
United Kingdom:							
Sterling bank deposits	0.1	0.1	0.4	0.1	-0.5	5.3	6.4
Eurocurrency bank deposits	2.4	-1.2	0.1	-2.0	-1.3	43.6	41.4
Government paper	0.3	-0.1	0.4	0.3	0.2	2.7	4.0
Other investments	0.1	-0.1	-0.2	-	-	6.0	8.6
	2.9	-1.3	0.7	-1.6	-1.6	57.6	60.4
Other EEC:(c)							
Domestic currency bank deposits	0.3	-	-0.3	0.3	0.2	3.7	5.0
Eurocurrency bank deposits	-0.4	0.1	1.5	-2.4	-1.8	21.3	20.0
Other investments	-0.2	-0.3	0.4	0.2	0.3	40.0	56.4
	-0.3	-0.2	1.6	-1.9	-1.3	65.0	81.4
United States:							
Bank deposits	-0.8	1.2	0.1	0.6	-1.0	19.8	20.7
Government paper	0.1	-2.2	0.1	-	-0.2	31.6	29.3
Other investments	-1.3	-0.7	-0.4	-0.2	-0.9	29.1	26.9
	-2.0	-1.7	-0.2	0.4	-2.1	80.5	76.9
Other:							
Domestic currency bank deposits	-0.1	0.4	0.5	-0.3	-0.6	3.0	4.7
Eurocurrency bank deposits	1.3	0.3	0.1	-1.8	-0.7	28.7	27.1
Other investments	-0.1	-0.1	-0.6	0.6(b)	5.5(b)	37.7	52.6
	1.3	0.6	-	-1.5	4.2	69.4	84.4
Offshore centres:							
Bank deposits	-4.7	1.3	2.7	-0.3	-1.8	38.0	39.9
Placements with Idcs	-0.2	-	0.2	-	0.1	59.2	59.5
OEC credit to non-banks	0.6	-0.1	-	-0.1	-	11.1	10.9
IMF and IBRD(d)	0.1	0.7	0.2	0.2	-	33.3	35.6
<b>Total identified additions(+)/reductions (-) in deployed assets</b>	<b>-2.3</b>	<b>-0.7</b>	<b>5.2</b>	<b>-4.8</b>	<b>-2.5</b>	<b>414.1</b>	<b>449.0</b>
Net funds available for deployment	-1.0	-1.2	2.3	-2.4	-8.6		
<i>of which:</i>							
Net movements in external borrowing etc	1.0	-1.2	-0.7	2.6	1.5		
Current balance	-2.0	-	3.0	-5.0	-10.1		

(a) The oil exporting countries covered are defined in the notes and definitions to Table 16 of the statistical annex in the March 1986 Bulletin.

(b) Provisional.

(c) Includes Spain and Portugal.

(d) Includes holdings of gold.

markedly in October. There was a relatively high volume of new euronote facilities, with an increased proportion of new facilities taking the form of uncommitted eurocommercial paper programmes. The credits market also saw increased activity, although this represents only a very minor part of the international capital markets.

## Fixed-rate bonds

The volume of fixed-rate bond issues remained subdued in September and October compared with the record totals of the first half of the year but increased from the summer's low levels. A total of \$30.9 billion was raised in September and October. With monthly seasonal adjustment of the data for fixed-rate bonds, new issues totalled \$27.9 billion.

Total US borrowing in September and October was \$4.7 billion, compared with \$3.6 billion in the two months to August. Eurobond investors have apparently become more wary of US corporate borrowers, whose borrowing costs have consequently increased relative to those of, for example, sovereign borrowers. This has made eurobond issues less attractive for US corporations, which have turned instead to their domestic bond market.



Borrowing by developing countries totalled \$460 million, consisting of issues for borrowers from Barbados, China, Hong Kong, India and Malaysia.

There continued to be demand for equity-related issues. Convertible issues and issues with equity warrants amounted to \$6.1 billion. Japanese issuers accounted for 64% of warrants issues and 31% of convertibles. There has generally been a move towards equity-related issues on the part of US borrowers. In 1985 under 6% of US borrowers' bond issues were equity-related, but so far this year the proportion has risen to 11% and was 13% in September and October. All but one of these issues were convertible bonds, in contrast to Japanese equity-related issues which have mainly taken the form of bonds with equity warrants.

There was little interest in variations on bonds. High-coupon issues (bonds carrying a coupon above market levels but issued at a premium and redeemed at par) amounted to \$2.4 billion. The interest in these issues ebbed during the autumn as the market assessed investor reaction to pressure by the Japanese Ministry of Finance on Japanese life assurance companies (the main market for the instruments) to exercise restraint in their investments in these instruments.

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

\$ billions; percentages in italics

	1984	1985	1986				Oct.
	Year	Year	Q4	Q1	Q2	Q3	
<b>Fixed-rate bonds</b>							
Borrower:							
Major OECD countries	46.8	70.5	20.1	31.2	34.6	26.0	9.2
of which:							
United States	20.0	30.2	9.0	11.0	10.5	6.5	1.8
Japan	14.4	19.0	4.1	5.8	8.5	8.3	3.4
Minor OECD countries	12.8	18.4	5.6	9.5	7.6	8.7	4.9
International institutions	12.4	15.7	4.1	5.3	3.5	3.9	1.5
Other	2.0	2.8	0.4	1.2	0.6	0.7	0.1
<b>Total</b>	<b>74.0</b>	<b>107.4</b>	<b>30.2</b>	<b>47.2</b>	<b>46.3</b>	<b>39.3</b>	<b>15.7</b>
Currency:							
US dollars	50.1	46.8	44.9	46.9	50.3	43.8	47.8
Swiss francs	17.4	13.7	18.2	13.1	10.6	15.5	19.4
Yen	8.0	11.3	11.5	15.9	7.7	14.9	9.3
Other	24.5	28.2	25.4	24.1	31.4	25.8	23.5
<b>Floating-rate notes</b>							
Borrower:							
Major OECD	21.6	38.6	11.5	5.4	7.0	15.0	2.4
Minor OECD	9.6	8.1	1.1	1.6	1.4	5.7	1.9
Other	2.8	8.6	1.8	1.4	0.9	0.1	0.3
<b>Total</b>	<b>34.0</b>	<b>55.3</b>	<b>14.4</b>	<b>8.4</b>	<b>9.3</b>	<b>20.8</b>	<b>4.6</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.

Dual-currency bond issues, where the issue price and coupon are calculated in one currency and the redemption price set in another at a predetermined exchange rate, remained at a low level. There were only three dual-currency issues, one in Swiss francs and dollars and two in yen and dollars.

The volume of issues denominated in dollars amounted to \$13.8 billion, 45% of new issues. The reluctance of investors to buy dollar bonds on the euromarket led some borrowers to launch issues on the domestic Yankee market instead; but there was comparatively greater interest in the non-dollar sectors of the euromarket than in dollar eurobonds. The volume of new issues

denominated in Swiss francs rose from Sw.Fc.6 billion in July and August to Sw.Fc.9.7 billion in September and October; the Swiss franc's market share rose from 14% to 18%. The yen's market share rose from 12% to 14% and sterling's fell from 3% to less than 1%.

#### Floating-rate notes

The summer's resurgence in the FRN market continued in September, but was followed by a slackening of activity in October as the market became satiated with floating-rate paper. Total issues rose from \$11.9 billion in July and August to \$13.5 billion, of which \$8.9 billion represented September's total alone.

UK borrowers account for the highest proportion of outstanding FRNs and for the largest amount of new borrowing. UK borrowing in the two months amounted to \$5.5 billion (47% of the total), all raised in September. The bulk of this total consisted of HM Government's \$4 billion ten-year issue. This was the largest issue ever launched, even before its increase from \$3 billion, and carried the finest terms. The coupon of  $\frac{1}{8}$ % below Libid was matched only by Denmark's \$1 billion issue in August, although the fees on the UK issue were slightly higher, at 33 basis points compared with 22.

With the UK issue, sovereign issues rose from \$2.5 billion in July and August to \$5.2 billion. The increase in issues in the FRN market in the summer of 1986 was led by sovereign borrowers, who were able to obtain increasingly fine terms. This is in contrast to the earlier part of the year, when fixed-rate bond issues combined with interest rate swaps offered a cheaper source of floating-rate finance than FRNs. During the year the margin over US Treasury bond yields payable on longer-dated interest rate swaps has increased: while the fixed-rate payer on, for example, a seven-year swap would have paid less than 60 basis points over Treasury bond yields in January, this margin had risen to over 120 basis points by August. At these levels, counterparties were hard to find, although swaps would have been attractive to issuers of fixed-rate bonds if they had been possible.

Over the same period, however, spreads on FRNs fell. Sovereign FRNs benefited particularly, perhaps because they have come to be seen as high-quality money-market instruments—competing with eurocommercial paper yielding below Libid—rather than banking assets required to yield a spread above Libor. Short-term or floating-rate instruments will have been more attractive to investors during a period when short-term rates were moving lower (allowing profits to be made by funding holdings overnight), but long-term rates were rising. Banks did not benefit from the fall in spreads to the same extent as sovereign borrowers. Issues by banks fell from \$5.6 billion in July and August to \$4.2 billion in September and October, compared with the record \$9.8 billion issued by banks in the fourth quarter of 1985.

Issues of perpetual FRNs amounted to \$1.4 billion. British banks were again active in this sector, but the



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

\$ billions

	1984		1985		1986			Oct.
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Committed(b)	18.20	33.14	5.01	8.50	3.41	6.12	2.41	1.27
Uncommitted	0.64	16.35	2.96	9.80	10.70	14.19	14.25	5.21
<b>Total</b>	<b>18.84</b>	<b>49.49</b>	<b>7.97</b>	<b>18.30</b>	<b>14.11</b>	<b>20.30</b>	<b>16.66</b>	<b>6.48</b>
<i>of which:</i>								
Major OECD	6.40	29.26	4.22	10.66	8.08	12.96	11.24	4.89
Minor OECD	11.20	17.55	3.34	6.93	5.43	6.22	5.17	1.44
Other	1.24	2.68	0.41	0.71	0.60	1.12	0.25	0.15
<b>Selected nationalities of borrower</b>								
United States	3.16	17.48	1.84	5.88	2.05	5.88	4.75	2.10
France	1.24	2.99	0.58	0.70	1.35	0.94	1.40	0.65
United Kingdom	0.72	3.82	1.00	1.92	1.48	1.23	0.67	0.43
Australia	2.72	7.90	1.68	3.96	1.17	1.90	0.50	0.85
Sweden	4.72	4.82	1.20	0.32	1.25	0.75	1.00	—

(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.

principal issuers were Australian banks, which are now allowed to include perpetual FRNs in their capital base.

The proportion of FRN issues denominated in dollars rose from 80% to 88%. Sterling-denominated FRNs accounted for 9% of the total compared with 8% in the previous two months. The only other currencies in which FRN issues were denominated were yen and Belgian francs.

**Euronote and other facilities**

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

The total value of euronote facilities announced in September and October was \$13.9 billion. This exceeded the previous three months' total by \$0.7 billion. The proportion of facilities which were non-underwritten or uncommitted, including eurocommercial paper (ECP) programmes, rose from 80% to 85% (by value). (These figures do not include uncommitted facilities where no amount is specified.)

The ECP market has grown steadily over the year, following its rapid growth in 1985 and the beginning of 1986, until it now dwarfs other sectors of the euronote market. Of all facilities in 1984, the proportion of uncommitted facilities (both ECP and the uncommitted parts of traditional NIFs) was just 3%; in 1985 it was 33%; and the proportion from January to end-October in 1986 was 77%.

Only two facilities in September and October were arranged for non-OECD borrowers, and there was only one facility (in ECU) not denominated in dollars. Total US borrowing in the euronote market was \$3.6 billion compared with \$3.3 billion in the preceding two months. ECP rates have usually been either equal to or slightly below those in the US domestic market, and consequently facilities now seem to be quite heavily drawn, rather than being arranged from purely precautionary motives. GMAC has had over \$1 billion outstanding under its

unlimited ECP programme, and has met with success particularly on its longer-dated paper; this appears to have enhanced the depth and trading liquidity of the ECP market. Facilities included two euro certificate of deposit programmes, each for \$1 billion, for Japanese banks.

The trend towards yet finer fees on euronote facilities was confirmed by a \$300 million deal for a French borrower, Crédit National, and also by a \$400 million facility for the Republic of Ireland. Both deals included split facility fees of four basis points, rising to five basis points. And a subsequent \$200 million deal for the Bank of New Zealand had even finer terms, with an underwriting fee of  $\frac{1}{32}\%$ , or  $\frac{3}{8}$  basis points, for five years.

Two facilities were arranged, for Electrolux (\$300 million) and American Life Insurance (\$100 million), which could herald the growth of euro medium-term note programmes to parallel the \$40 billion US market. Medium-term note programmes offer securities continuously in the same way as commercial paper, but for longer maturities.

**Eurocurrency syndicated lending**

The total value of syndicated credits announced in September and October was \$5.3 billion, compared with \$3.9 billion in the previous two months. Eleven loans, 17% of the total, were denominated in currencies other than dollars.

Few top-quality OECD borrowers now use the syndicated credits market, being able to obtain finer terms in other markets. Among OECD countries, US borrowers raised \$1.3 billion in the credits market. There were four loans for Turkish borrowers, which appeared to confirm a slight improvement in the country's credit rating. Borrowing by developing countries is also at a low level and credits for OPEC countries amounted to only \$330 million in September and October.

South Korean borrowing has fallen sharply during the year because of the strengthening of the country's balance of payments. There was one loan for a Korean borrower in the latest period. A \$500 million loan for India's Oil and Natural Gas Commission included two tranches that were tax-spared, by Japan (for \$125 million) and the United Kingdom and Belgium (for \$75 million) respectively. Chinese borrowers raised \$475 million.

There were two credits for East European borrowers, the National Bank of Hungary and the Soviet Vneshtorgbank. The National Bank of Hungary's \$100 million credit

**Announced eurocurrency syndicated credits**

\$ billions

	1984		1985		1986			Oct.
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Major OECD	9.90	5.06	1.10	1.40	2.21	2.02	1.98	1.15
Minor OECD	6.16	4.40	0.86	0.49	1.38	0.90	2.03	0.92
Developing countries	7.17	3.92	1.29	0.08	1.25	0.68	1.38	0.25
Eastern bloc	2.19	3.55	0.71	0.46	0.50	0.88	0.15	0.30
Other	4.69	1.99	0.54	0.70	1.66	1.43	1.42	0.63
<b>Total</b>	<b>30.11</b>	<b>18.92</b>	<b>4.50</b>	<b>3.13</b>	<b>7.00</b>	<b>5.91</b>	<b>5.96</b>	<b>3.25</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>1.05</i>	<i>0.10</i>	<i>0.26</i>



carried the finest terms so far obtained on a publicised deal for Hungary.

### International banking developments

*This section concentrates on developments in the international business of banks in the BIS reporting area in the second quarter of 1986 and, separately, the business of banks in the London market in the third quarter of 1986.*

#### Banks in the BIS reporting area (second quarter of 1986)

There was a sharp acceleration in the growth of BIS-area banks' cross-border lending in the second quarter of 1986, with one of the highest recorded increases since 1981 (exceeded only by the exceptional growth in the fourth quarter of 1985). This rapid expansion can be largely accounted for by an unusually high rise in interbank lending within the BIS reporting area, which to a large extent was attributable to operations involving reporting banks in the 'offshore' centres of the Caribbean, the Middle East and the Far East. Another factor accounting for the growth of interbank business in the second quarter was the continued expansion of the international activities of Japanese banks.

The expansion in banks' international business was fairly evenly spread over the BIS reporting area. Over half the growth in total claims was attributable to the European market centres, particularly banks in the United Kingdom and Germany. In Germany, the expansion coincided with a rapid increase in banks' net external asset positions, in part the result of purchases of international securities,

particularly those denominated in deutschemarks.

Outside Europe, banks in the United States increased both their external assets and their external liabilities (by \$10 billion and \$3.4 billion respectively), resulting in an expansion of their net external creditor position for the first time since the first quarter of 1983. This can be attributed partly to transfers of funds by US banks to their own offices abroad to offset reduced deposits obtained by these offices from other sources.

Net of redepositing of funds between reporting banks, estimated lending to final users rose by \$30 billion in the second quarter of 1986, a little higher than in the previous quarter, and also above the average quarterly rises recorded in 1984 and 1985. This rise included a sharp turnaround in lending to countries outside the BIS area, following the partly seasonal decline in the previous quarter. Partly offsetting this resumption of new lending outside the reporting area, borrowing by non-banks within the BIS area was slack in the second quarter.

With lending to countries outside the reporting area rising by \$5 billion during the second quarter compared with a \$9 billion fall in the first and a further decline (albeit slower) in these countries' deposits, outside-area countries sharply increased their net borrowing from BIS-area banks, between the first and second quarters, from \$1.6 billion to \$9.1 billion.

Oil exporting countries made a further large drawdown of their deposits with BIS-area banks in the second quarter, as falling oil prices increased their collective current account deficit. The small rise in claims on the oil exporting countries was mainly accounted for by Algeria. Developed countries outside the BIS area increased both their borrowings and their deposits in the second quarter.

Over half the second quarter growth in BIS-area banks' claims on countries outside the reporting area was on Eastern Europe, the bulk in lending to the Soviet Union. Claims on Latin American countries in aggregate were unchanged, lending to Argentina rising by \$1.2 billion, as new money was drawn in connection with an IMF adjustment programme, and claims on other major Latin American countries, particularly Brazil and Uruguay, declining. At the same time, a decline in Mexico's deposits with BIS-area banks more than accounted for the overall fall in Latin American countries' total deposits in the second quarter. Among the other non-oil developing countries, Taiwan added a further \$2.1 billion to its deposits with BIS-area banks.

There was strong growth in cross-border lending denominated in US dollars in the second quarter, accounting for almost half of BIS-area banks' claims and two thirds of new cross-border deposits. This resurgence contrasts with modest growth in the previous quarter. Deutschemark and lira-denominated claims also recorded significant rises, the latter following a partial relaxation of the Italian regulations governing export financing in lire. Lending denominated in yen fell back in the second

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

\$ billions; changes exclude estimated exchange rate effects

	1984		1985		1986			Outstanding at end-June 1986
	Year	Year	Q4	Q1	Q2			
<b>Deposits from:</b>								
BIS reporting area(a)	+ 98.6	+178.5	+ 88.5	+35.1	+46.7		1,760.0	
'Offshore' banking centres(b)	+ 23.4	+ 43.7	+ 27.8	+ 5.7	+18.1		459.6	
Sub-total	+121.9	+222.1	+116.3	+40.7	+64.7		2,219.6	
Developed countries	+ 3.2	+ 3.1	- 0.6	- 0.4	+ 1.4		37.6	
Eastern Europe	+ 4.3	+ 2.7	+ 1.8	- 1.1	+ 0.1		27.4	
Oil exporting countries	+ 2.2	+ 7.5	+ 5.6	- 6.9	- 7.4		149.7	
Non-oil developing countries	+ 19.6	+ 5.4	+ 4.7	- 2.2	+ 1.8		182.5	
of which, Latin America	+ 10.2	+ 0.4	+ 0.6	+ 0.6	- 0.2		70.4	
Sub-total	+ 29.5	+ 18.7	+ 11.4	-10.6	- 4.1		397.2	
Unallocated	+ 0.3	+ 0.7	- 2.7	+ 5.4	+ 4.3		88.4	
<b>Total</b>	<b>+151.6</b>	<b>+241.5</b>	<b>+125.0</b>	<b>+35.5</b>	<b>+64.9</b>		<b>2,705.2</b>	
<b>Lending to:</b>								
BIS reporting area(a)	+ 91.7	+181.0	+ 92.9	+35.9	+44.0		1,635.9	
'Offshore' banking centres(b)	+ 21.8	+ 24.1	+ 16.5	- 1.1	+22.2		431.8	
Sub-total	+113.5	+205.2	+109.4	+34.8	+66.2		2,067.7	
Developed countries	+ 5.4	+ 6.8	+ 1.9	- 0.5	+ 1.6		108.1	
Eastern Europe	—	+ 5.6	+ 1.4	- 0.4	+ 2.8		67.3	
Oil exporting countries	- 1.9	+ 0.1	+ 1.6	- 3.4	+ 0.6		111.8	
Non-oil developing countries	+ 10.0	+ 10.8	+ 5.3	- 4.8	—		356.2	
of which, Latin America	+ 5.4	+ 1.6	+ 1.4	- 2.3	—		219.3	
Sub-total	+ 14.2	+ 23.3	+ 10.2	- 9.0	+ 5.0		643.4	
Unallocated	—	+ 3.8	+ 1.5	+ 1.5	+ 2.2		60.6	
<b>Total</b>	<b>+127.7</b>	<b>+232.2</b>	<b>+121.1</b>	<b>+27.4</b>	<b>+73.4</b>		<b>2,771.7</b>	

(a) Excluding 'offshore' reporters.

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



quarter, although new euroyen credits to non-banks accounted for nearly 40% of total new non-dollar eurolending to non-banks. New lending in ECUs slowed down markedly in the second quarter.

The BIS press release analyses lending to certain problem debtor countries (those with external debt of over \$1 billion to BIS-area banks at end-June 1986 and which have rescheduled part of these debts during 1982-85). The table illustrates the continuing lack of voluntary lending by BIS-area banks to these countries. There have been net repayments by these debtor countries to BIS reporting banks of \$2.3 billion over the last 2½ years despite about \$15 billion of new money packages arranged for certain countries in conjunction with IMF-sponsored programmes. In the same period, BIS-area banks' total claims on 'other' outside-area countries—mainly developed countries—have risen in aggregate by \$35 billion.

### Banking credit flow to groups of countries outside the BIS reporting area 1984-86

\$ billions at constant end-of-quarter exchange rates

	1984	1985	1986	Outstanding gross claims at end-June 1986
	Year	Year	HI	
Problem debtor countries (a)	0.7	1.0	-4.0	309.3
Other outside-area countries	12.8	22.3	—	334.1

(a) Defined as those which at end-June 1986 had debts to the BIS reporting banks in excess of \$1 billion and which had rescheduled part of these debts within the last four years, i.e. Argentina, Brazil, Chile, Cuba, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Poland, Rumania, South Africa, Sudan, Uruguay, Venezuela and Yugoslavia.

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

The third quarter saw a sharp acceleration in the rate of growth of cross-border lending by banks in the United Kingdom, with an increase in claims of \$45 billion, nearly as much as in the whole of the previous twelve months. Virtually all the rise was accounted for by a surge in interbank lending to banks in the BIS reporting area, but banks' securitised lending also continued to grow strongly.

Around half the growth of interbank lending was to banks in Japan, to a large extent representing the transfer of funds from the branches of Japanese banks in London to their head offices; such transfers tend to rise at the end of half-yearly accounting periods in September and March. There was also a substantial rise in lending to banks in the United States, after little change in the previous quarter. Claims on banks in the 'offshore' centres, particularly Singapore, the Cayman Islands and Hong Kong, again grew strongly.

There was little aggregate increase in lending to countries outside the BIS reporting area, although claims increased on Taiwan, New Zealand and, again, the Soviet Union and East Germany. Claims on Latin America fell slightly, with a further small increase in claims on Argentina more than offset by reductions on Brazil, Mexico and Chile. In the first three quarters of 1986 there has been a small reduction in lending by UK banks to developing countries.

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

\$ billions; changes exclude estimated exchange rate effects

	1984	1985	1986				
	Year	Year	Q3	Q4	Q1	Q2	Q3
<b>Deposits from:</b>							
BIS reporting area(a)	+25.3	+40.9	+13.2	+15.7	+12.4	+6.8	+38.1
'Offshore' banking centres(b)	+6.8	+5.2	+1.1	+0.2	+1.6	+2.9	+8.0
Sub-total	+32.1	+46.1	+14.3	+15.9	+14.0	+9.7	+46.1
Developed countries	+1.4	+1.4	+1.2	-0.6	-0.3	+0.2	+1.4
Eastern Europe	+0.9	+1.3	+0.7	+0.7	-0.3	-0.4	—
Oil exporting countries	-1.2	+1.8	-1.1	+0.5	-1.9	-1.8	-2.6
Non-oil developing countries	+4.8	-1.0	-1.6	+1.1	-1.0	+0.4	+0.7
of which, Latin America	+2.9	-2.2	-0.5	-0.8	+0.6	-0.8	-0.3
Sub-total	+5.9	+3.5	-0.8	+1.7	-3.5	-1.6	-0.6
Others	-1.8	-0.7	—	-0.4	+0.6	-0.9	-0.1
<b>Total</b>	<b>+36.2</b>	<b>+48.9</b>	<b>+13.4</b>	<b>+17.1</b>	<b>+11.1</b>	<b>+7.3</b>	<b>+45.4</b>
<b>Lending(c) to:</b>							
BIS reporting area(a)	+16.0	+30.1	+14.3	+11.0	+15.9	+4.3	+37.9
'Offshore' banking centres(b)	+9.3	-4.4	-3.7	-2.3	+0.4	+5.6	+7.7
Sub-total	+25.3	+25.7	+10.6	+8.7	+16.2	+9.9	+45.6
Developed countries	+1.2	+2.3	—	+1.4	+0.3	-0.3	-0.1
Eastern Europe	-0.4	+3.3	+1.3	+1.0	+0.3	+1.1	+0.4
Oil exporting countries	-1.0	-0.5	-0.5	+0.2	-0.7	+0.8	—
Non-oil developing countries	+1.1	+2.9	+1.9	+0.8	-1.9	+0.1	-0.1
of which, Latin America	+1.9	+1.5	+1.8	-0.1	-0.2	-0.3	-0.2
Sub-total	+0.8	+8.0	+2.7	+3.4	-1.9	+1.7	+0.2
Others	-0.8	-1.1	—	-1.2	+0.2	+0.1	-0.4
<b>Total</b>	<b>+25.3</b>	<b>+32.6</b>	<b>+13.3</b>	<b>+10.9</b>	<b>+14.6</b>	<b>+11.7</b>	<b>+45.3</b>

(a) Excluding 'offshore' reporters.

(b) 'Offshore' reporters and other 'offshore' centres.

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

On the sources side of the market, there was also a very large rise in interbank deposits from banks in centres within the BIS reporting area (particularly Japan and the United States), in marked contrast to the previous quarter when there was a small fall. Non-banks within the BIS reporting area continued to be net suppliers of funds to UK banks, although on a smaller scale than in the second quarter.

In the third quarter oil exporting countries drew down their deposits with UK banks on a larger scale than in each of the first two quarters of the year. This contraction was offset to some extent by increased deposits by developed countries outside the BIS reporting area and, to a lesser degree, by non-oil developing countries, particularly Taiwan. Overall, countries outside the reporting area were small net takers of funds from banks in the United Kingdom.

As in the second quarter, around two thirds of total cross-border lending was dollar-denominated. Nearly a fifth was in yen, which at the end of the quarter accounted for around 8% of outstanding lending, bringing it close to the currency with the second-largest share, the deutschmark.

### Foreign exchange and gold markets

*This section reviews the two months to end-October.*

Sterling came under renewed and at times heavy pressure during the period under review, largely reflecting oil price considerations against a background of concern over the outlook for the UK economy. It was able to recover some ground by the end of the period, however, following the firming of oil prices and a 1% increase in UK banks' base rates in mid-October. The dollar was volatile as US officials initially continued to propound the need for

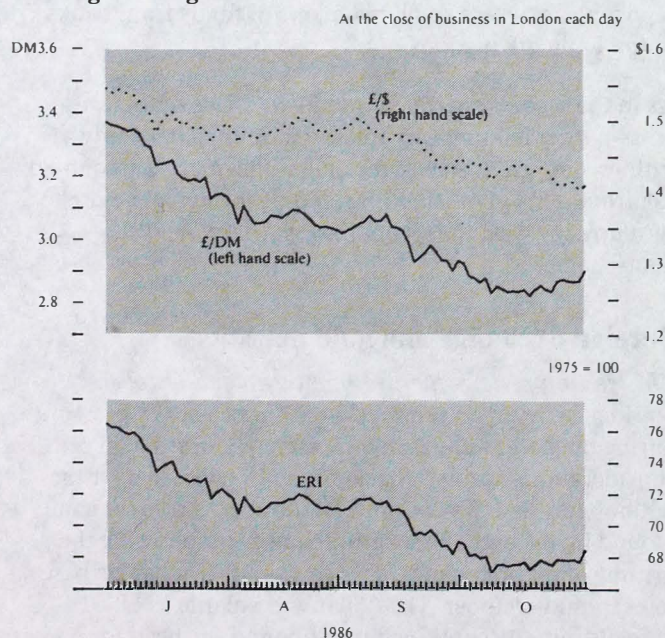


further depreciation and faster growth abroad in order to help correct the record US trade deficit, while the German and Japanese authorities contended that exchange rates were at appropriate levels and a number of central banks reportedly intervened to stabilise the dollar. In late October, the dollar rallied on improved US economic indicators, firmer interest rates and Japanese investment demand in the latest US Treasury bond auctions. The dollar's improvement was reinforced by the  $\frac{1}{2}$ % cut in the Japanese discount rate and by the agreement between US Treasury Secretary Baker and Japanese Finance Minister Miyazawa on the dollar/yen exchange rate, which was interpreted by the market as a constraint on the dollar's further depreciation.

### Sterling

The pound opened the period on 1 September in London at ERI 71.0, \$1.4910 and DM 3.0215. It was briefly depressed by a pessimistic forecast for the UK economy published by the Confederation of British Industry and touched a then all-time low of DM 3.0177. However, firm oil prices, the weaker dollar and the success of HM Government's \$4,000 million floating-rate note issue quickly lifted the pound and it reached highs of \$1.5072 on 4 September and DM 3.0843 on 8 September before being depressed again by a sharp fall in oil prices. On 17 September, as the deutschemark moved up on comments from Bundesbank President Poehl which seemed to rule out any early interest rate cuts in Germany, sterling fell below the DM 3 level for the first time. Although it remained fairly steady against the dollar at first, on 18 September selling from Middle Eastern sources took the pound below ERI 70 and \$1.47, at which point market sentiment appeared to become generally bearish. The stronger dollar, and then the announcement on 24 September of a record UK trade deficit for August, led to a sharp fall. After touching \$1.4275 in the Far East on 26 September, the pound steadied on general market caution

### Sterling exchange rates



ahead of the IMF/IBRD Annual Meetings in Washington, at which the Group of Five and Group of Seven industrial countries were expected to discuss further international policy co-ordination. Following the meetings in Washington, however, the pound met renewed selling pressure as the attention of the market was deflected from the dollar by fear of central bank intervention to stem the latter's fall. Lows of ERI 68.2 and DM 2.9033 were touched at the close on 29 September before the pound rallied on short-covering, helped by official support, to finish the month at ERI 69.0, \$1.4477 and DM 2.9352.

Selling pressures on sterling soon re-emerged in October as the market focussed on concerns about UK economic prospects and with uncertainty over oil price prospects highlighted by the OPEC meeting which convened on 5 October. The pound also suffered once again as dealers became cautious about selling dollars after reported concerted central bank support. In very active trading, sterling fell to a record low of ERI 67.1 on 8 October but rallied in advance of the Chancellor's speech to the Conservative Party Conference on 9 October on the belief that he would use the opportunity to make a major announcement on interest rate or exchange rate policy. Similar expectations again helped sterling a week later, before the Chancellor's Mansion House speech. On both occasions, however, sterling's gains were quickly surrendered when market expectations were not realised. The pound received more durable support following the 1% increase (to 11%) in UK banks' base rates on 14 October (although an all-time low of DM 2.8145 was recorded on 17 October). It was also helped in the middle of the month by firmer oil prices following apparent moves within OPEC towards agreement on extending temporary production restraints and then, on 19 October, after a brief bout of nervousness, by news of the replacement of Sheik Yamani as Saudi Oil Minister by Mr Hisham Nazer, who it was expected would redirect Saudi Arabia's oil policy towards achieving a higher level of prices. Notwithstanding a fall to a low of \$1.3955 on 31 October as the dollar rallied, the pound recovered sharply against Continental currencies to finish the period at ERI 68.4 (- 3 $\frac{3}{4}$ % over the period), \$1.4085 (- 5 $\frac{1}{4}$ %) and DM 2.9029 (- 4 $\frac{1}{4}$ %).

### Official reserves

Over the two months to end-October, the reserves increased by \$3,068 million to \$21,992 million, largely reflecting the receipt of the proceeds of HM Government's \$4,000 million floating-rate note issue in the international

### Changes in UK official reserves

	1986	
	Sept.	Oct.
<b>Change in reserves</b>	<b>+3,502</b>	<b>-434</b>
<i>of which:</i>		
Net borrowing (+)/payment (-)		
of public debt	+3,874	+326
Valuation change on roll-over of EMCF swap	—	- 92
Underlying change in reserves	- 372	-668
<b>Level of reserves (end of period)</b>	<b>22,426</b>	<b>21,992</b>

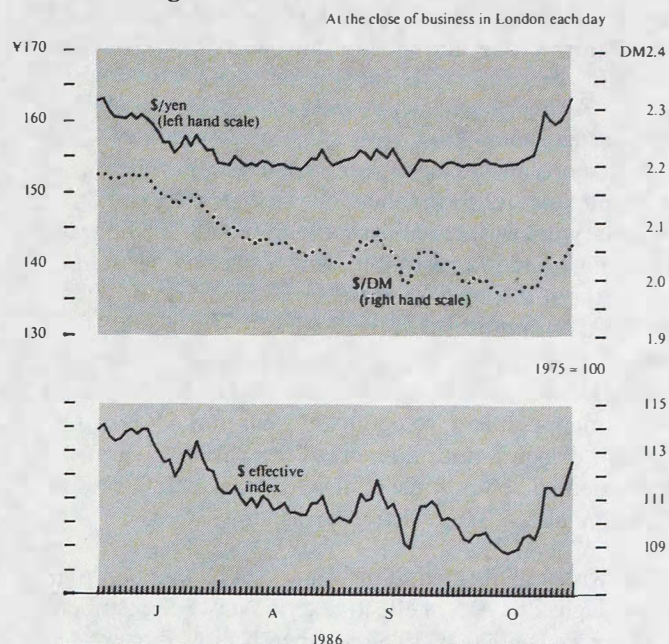


capital markets. Net public sector borrowing under the exchange cover scheme totalled \$217 million but there was a decrease of \$92 million on account of the valuation adjustment arising from the quarterly roll-over of the United Kingdom's ECU holding with the European Monetary Co-operation Fund. The underlying change in the reserves was a fall of \$1,040 million.

### US dollar

The dollar fluctuated widely over the period. It recovered from early weakness to reach a high of DM 2.1037 on 12 September but fell back to a low of DM 1.9692 on 17 October before rallying to DM 2.0770 towards the end of October. A significant part of the dollar's volatility reflected a continuation of contradictory official influences. On the one hand, US officials continued to make statements about the need for further depreciation of the currency to promote the adjustment of external imbalances in the absence of more vigorous reflation by Germany and Japan. At the start of the period, the dollar was depressed by such remarks by US Trade Representative Yeutter, shortly after the announcement of the record US trade deficit in July, and similar comments by US Treasury Secretary Baker on 18 September helped force it down below the psychologically-significant DM 2 level. On the other hand, German and Japanese officials remained unsympathetic towards US calls for further action to boost domestic demand in their economies. Market participants also reported central bank dollar purchases around the DM 2 level, and on 20 October the dollar was boosted by a statement by Bundesbank President Poehl that its value had fallen far enough, which the market interpreted as a signal of the Bundesbank's determination to oppose further depreciation through market intervention. The dollar's volatility also reflected uncertainty about the likelihood of some further move towards greater international exchange rate management and, in particular, some agreement to stabilise the dollar following on from the Plaza agreement of last September. Thus, the dollar firmed sharply in response to the reported agreement by EC central bank Governors at their Gleneagles meeting over the weekend of 20/21 September to co-operate to stabilise the dollar and in anticipation of the meetings of the Group of Five (G5) and Group of Seven (G7) industrial countries in the margins of the IMF/IBRD Annual Meetings, but fell back again when the G5 and G7 disappointed hopes of some concerted action. Uncertainty was increased by changing expectations about US economic performance. Rumours of very strong retail sales in August, against a background of revived optimism over US economic prospects, helped trigger the dollar rally in early September after Yeutter's remarks, only for it to fall back on the eventual modest outturn. More disappointing statistics reinforced the dollar's subsequent weakness, before improved September figures for the US trade deficit (\$12.6 billion) and durable goods orders (+ 4.9%) inspired a further rally. The latter also reflected expected Japanese investment demand in the latest round of US Treasury bond auctions and firmer US interest rates

### Dollar exchange rates



attributed to inflationary fears and the US Treasury refunding.

On 31 October, the dollar received a further boost from the announcement of a  $\frac{1}{2}$ % cut (to 3%, with effect from 1 November) in the Japanese discount rate and the joint statement from Treasury Secretary Baker and Finance Minister Miyazawa that 'the exchange rate realignment achieved between the yen and the dollar since the Plaza agreement is now broadly consistent with the present underlying fundamentals'. Although the statement made no reference to any specific exchange rate target or to any commitment to particular action, it did affirm a willingness to co-operate in relieving pressures in the foreign exchange market, which the market saw as putting a cap on further yen appreciation. Over the period under review, the dollar appreciated by 1 $\frac{1}{8}$ % to finish at DM 2.0610, by 5 $\frac{3}{8}$ % to ¥ 163.50 and, in effective terms,<sup>(1)</sup> by 2% to 112.6. From the close of business in New York on 20 September 1985, just before the G5 Plaza meeting, the dollar depreciated by 27 $\frac{1}{2}$ % against the deutschemark, 31 $\frac{1}{2}$ % against the yen and 19 $\frac{3}{8}$ % in effective terms.

### EMS

The strength of the deutschemark stretched the narrow band to its limits and the Danish krone exceeded its divergence threshold on several occasions in September. From the second half of the month, however, the narrow band remained within 2%. For the whole of the period, the deutschemark remained at the top. The Danish krone was at the bottom continuously until the middle of October, largely depressed by concerns over the Danish balance of payments. Subsequently the krone alternated with the Belgian franc, which was affected, in part, by domestic political tensions. Over the two months under review, the Irish pound moved lower within the system, to an extent reflecting pressures on the dollar and sterling; the official short-term facility rate was increased twice. The Italian

(1) The effective exchange rate indices quoted in this article are calculated by the Bank, on the basis of 1975 = 100.



lira remained above the narrow band throughout. The latter finished  $1\frac{1}{8}\%$  wide between the deutschemark and the Danish krone, and the lira finished  $1\frac{1}{16}\%$  above the mark.

#### Other currencies

The yen reached an all-time high of ¥ 151.77 on 19 September following the remarks by US Treasury Secretary Baker. It eased back after news of the Gleneagles agreement and lost ground thereafter on growing doubt about the strength of Japanese domestic demand. The yen steadied on rumours that the Bank of Japan would intervene at ¥ 162 and made up ground against the deutschemark, before easing back to ¥ 164.50 on strong investment demand for dollars, the cut in the Bank of Japan's discount rate and news of the Baker/Miyazawa agreement. The yen finished the period at ¥ 163.50, down  $5\frac{1}{8}\%$ , and at 206.3 in effective terms, down  $4\frac{1}{8}\%$ .

The Swiss franc firmed to the middle of September to reach highs of 170.5 in effective terms on 18 September and Sw. Fc. 1.6000 on 19 September. It moved back sharply by the end of October in response to easier domestic money-market conditions, to touch a low on 31 October of Sw. Fc. 1.7245, before closing the period at

Sw. Fc. 1.7147, down  $4\frac{1}{4}\%$ , and a low of 164.7 in effective terms, down  $2\frac{3}{8}\%$ .

The Norwegian krone was subject to serious pressure at the beginning of October on fears that the 1987 budget would include a krone depreciation. A low of N Kr 7.2575 was touched on 14 October. By the end of the period, the krone had recovered some of its losses, to finish at N Kr 7.5212, down  $3\frac{1}{8}\%$ , and a low of 78.1 in effective terms, down  $1\frac{3}{8}\%$ .

#### Gold

Gold was active and very volatile, mainly reflecting fluctuations in platinum prices and the dollar. It fixed at \$391.75 on 1 September but reached a 40-month high of \$442.75 on 22 September, only to fall back by the end of the period. The early demand for gold was attributed to investment interest inspired by volatility in the international financial markets and renewed concerns about inflation. The surge in platinum prices resulting from the political uncertainty in South Africa led to a parallel rise in gold, and platinum's subsequent fall triggered gold's decline towards the end of the period. The final fixing in London was at a low of \$401, up \$16.30 over the period.