# International financial developments

*Among the main developments:*

- *The combined current account of the major seven industrial countries continued to strengthen in the third quarter of 1986, but imbalances widened further with sharp increases in the German and Japanese surpluses and a rise in the US deficit.*

- *In the capital markets, the perpetual FRN market temporarily ceased trading on 3 December, apparently in response to a general feeling that spreads on perpetual FRNs had been driven to unrealistically low levels. There was a consequent reappraisal of the correct value of perpetual FRNs issued by banks which, in a narrowly-based market, led to the suspension of trading.*

- *There was a record growth in the external assets of banks in the BIS reporting area in the third quarter of 1986. This was almost entirely lending within the reporting area: most of it was interbank activity, dominated by Japanese banks, but the increase in lending to final users was also exceptional—the highest quarterly increase since 1981.*

- *In the foreign exchange markets, the dollar fell back sharply against Continental European currencies, particularly the deutschemark. The strength of the deutschemark brought pressure on the EMS and the system became fully stretched by the end of the period.*

## Balance of payments positions

The combined current account of the *major seven economies* is estimated to have continued to strengthen in the third quarter of 1986, but imbalances among the three largest economies widened further, with increased surpluses in Japan and Germany more than offsetting a further rise in the US deficit. Among the other major countries, an increase in the deficit on net manufacturing trade led to a small overall current account deficit for the United Kingdom during the third quarter, while a steep rise in imports is estimated to have resulted in a widening of the Canadian deficit.

**World current accounts**[a]

$ billions; *seasonally adjusted*

| | 1984 | 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 | — | 2 |
| Germany | 7 | 14 | 4 | 4 | 8 | 8 | 11 |
| Italy | - 3 | - 4 | 2 | - 1 | - 2 | — | 3 |
| Japan | 35 | 49 | 13 | 15 | 15 | 22 | 26 |
| United Kingdom | 1 | 4 | 1 | 1 | 1 | 1 | - 1 |
| United States | -107 | -118 | -28 | -34 | -34 | -34 | -36 |
| Major economies | - 65 | - 56 | - 9 | -15 | -13 | - 4 | 2 |
| Other OECD | - 2 | - 3 | — | - 1 | — | 2 | 4 |
| Total OECD | - 67 | - 59 | - 9 | -16 | -13 | - 2 | 6 |
| OPEC economies | - 12 | - 1 | — | - 3 | - 7 | -10 | -10 |
| Non-OPEC developing economies | - 18 | - 27 | - 7 | - 6 | - 7 | - 4 | - 2 |
| Other economies(c) | 6 | 5 | 2 | 1 | — | — | - 1 |
| World discrepancy(d) | - 91 | - 82 | -14 | -24 | -27 | -16 | - 7 |

(a) Components may not add due to rounding.
(b) Includes Bank estimates/forecasts.
(c) The centrally planned economies and South Africa.
(d) Equals the overall identified balance. The negative sign implies that errors arising from incomplete coverage, timing differences and other statistical deficiencies are resulting in the omission of positive influences (eg unrecorded services and investment income).

**Non-OPEC developing countries' balance of payments**

$ billions; *not seasonally adjusted*

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

(a) Includes Bank estimates.
(b) Adjusted to exclude valuation effects.
(c) Unidentified terms which may include net errors and omissions on both the current and capital accounts.

Revisions to second and third quarter trade flow data have reduced the estimated combined current account deficit for the *non-OPEC developing countries*, with continued export growth in the newly industrialising countries together with import restraint (particularly by the net oil exporters) accounting for the more balanced aggregate position.

Capital account flows of the major economies in the first half of 1986 continued to be dominated by the expansion of portfolio investment in the United States by non-residents (and outward flows from Japan). More recent third quarter figures suggest that portfolio outflows from Japan have since strengthened further. Expectations of a downward trend in interest rates and rising bond prices probably helped stimulate foreign demand for US bonds in the first half of 1986. Net capital account flows through the banking system also show a notable pattern. The long-running net inflow through the US banking system went into reverse in the first half of 1986 in association with slack domestic loan demand. In contrast, the United Kingdom and Japan have experienced net inflows through this source for some time (Japanese banks, in particular, seem to have been 'borrowing short' to 'lend long' at least since 1984, a development in part reflecting the process of liberalisation and deregulation in Japan). Net outflows through the German banking system were strong during the first three quarters of 1986, amounting to $13 billion. Offsetting these outflows was a $16 billion inflow through portfolio investment, the reverse of the Japanese position.

Identified assets of *oil exporting countries* fell by $11.3 billion in the third quarter, making a total reduction in the first three quarters of 1986 of $17.4 billion.

**Identified deployment of oil exporters' funds**(a)

$ billions

| | Sept. 1985 levels | 1985 Q4 | 1986 Q1 | 1986 Q2 | 1986 Q3(b) | Sept. 1986 levels |
|---|---|---|---|---|---|---|
| **Industrial countries** | | | | | | |
| United Kingdom: | | | | | | |
| Sterling bank deposits | 5.8 | 0.4 | 0.1 | - 0.5 | — | 6.1 |
| Eurocurrency bank deposits | 43.1 | 0.1 | -2.0 | - 1.3 | - 2.6 | 39.4 |
| Government paper | 2.8 | 0.4 | 0.3 | 0.2 | 0.2 | 4.0 |
| Other investments | 6.5 | -0.2 | — | — | — | 7.3 |
| | 58.2 | 0.7 | -1.6 | - 1.6 | - 2.4 | 56.8 |
| Other EEC:(c) | | | | | | |
| Domestic currency bank deposits | 4.1 | -0.3 | 0.3 | 0.1 | 0.4 | 5.8 |
| Eurocurrency bank deposits | 21.8 | 1.5 | -2.3 | - 1.8 | - 1.0 | 19.3 |
| Other investments | 42.7 | 0.4 | 0.2 | 0.4 | — | 60.9 |
| | 68.6 | 1.6 | -1.8 | - 1.3 | - 0.6 | 86.0 |
| United States: | | | | | | |
| Bank deposits | 21.6 | 0.1 | 0.6 | - 1.0 | 1.0 | 22.2 |
| Government paper | 29.4 | 0.1 | — | - 0.2 | - 2.0 | 27.4 |
| Other investments | 28.4 | -0.4 | -0.2 | - 1.0 | - 0.5 | 26.2 |
| | 79.4 | -0.2 | 0.4 | - 2.2 | - 1.5 | 75.8 |
| Other: | | | | | | |
| Domestic currency bank deposits | 3.8 | 0.5 | -0.3 | - 0.5 | 0.2 | 5.2 |
| Eurocurrency bank deposits | 29.2 | 0.1 | -1.8 | - 0.7 | - 1.3 | 25.9 |
| Other investments | 40.1 | -0.6 | 0.6 | 5.5(b) | - 6.5 | 46.9 |
| | 73.1 | — | -1.5 | 4.3 | - 7.6 | 78.0 |
| Offshore centres: | | | | | | |
| Bank deposits | 39.3 | 2.7 | -0.3 | - 1.8 | 0.9 | 40.8 |
| Placements with ldcs | 59.2 | 0.2 | — | 0.1 | — | 59.5 |
| OEC credit to non-banks | 11.0 | — | 0.7 | 0.4 | — | 12.0 |
| IMF and IBRD(d) | 34.3 | 0.2 | 0.2 | — | - 0.1 | 39.0 |
| **Total identified additions(+)/reductions (−) in deployed assets** | **423.1** | **5.2** | **-3.9** | **- 2.2** | **-11.3** | **447.9** |
| Net funds available for deployment | | 2.3 | -4.4 | - 8.6 | - 8.4 | |
| *of which:* | | | | | | |
| *Net movements in external borrowing etc* | | *-0.7* | *2.6* | *1.5* | *1.6* | |
| *Current balance* | | *3.0* | *-7.0* | *-10.1* | *-10.0* | |

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

(b) Provisional.

(c) Includes Spain and Portugal.

(d) Includes holdings of gold.

Estimates suggest that the oil exporting countries' combined current account continued to be in large deficit—$10 billion during the quarter and $27.1 billion in the first three quarters of 1986. Within the capital account, eurocurrency bank deposits again fell (by $4.0 billion) although domestic bank deposits rose, by a modest $1.6 billion overall. In the United States there were larger withdrawals from longer-term investments, including government paper, which amounted to some $2.5 billion, and investments in other industrial countries also fell sharply (although there was a small rise in UK government paper).

## International capital markets

There was reduced activity in all sectors of the international capital markets in November and December, with the minor exception of the syndicated credits market. The decline in FRN issues was particularly marked, and there were problems in December in the perpetual FRN sector as a result of which many houses temporarily suspended trading in perpetual issues.

### Fixed-rate bonds

The volume of fixed-rate bond issues in November and December fell by $6.7 billion from the previous two months' total to $24.2 billion. However, there is normally a seasonal decline in issuing activity at the end of the year, and taking seasonal factors into account this represents a fall of 7%.

There was a marked decline in issues for US borrowers, from $4.7 billion in September and October to $1.6 billion, continuing a trend seen through most of the second half of the year. Fears of a rise in inflation, combined with volatility in equity prices, contributed to a reduction in investors' demand for eurobonds. Investors treated US corporate borrowers with some circumspection, partly owing to expectations of further falls in the dollar, but possibly also as a response to the downgrading of some US firms.

Japanese borrowing amounted to $5.2 billion, compared with $6.4 billion in September and October, while the most active European borrower was Denmark—total Danish issues were $2.6 billion. Borrowing by developing countries totalled only $160 million, consisting of issues for Chinese and Singaporean borrowers.

There continued to be demand for equity-related issues, albeit at lower levels (particularly for Japanese and US borrowers) than in the previous two months. Convertible issues and issues with equity warrants amounted to $3.5 billion, compared with $6.1 billion in September and October. Unusually, Japanese borrowers accounted for less than half (48%) of warrants issues, and they also accounted for 37% of convertibles. Whereas there had been no Swiss warrants issues in September and October, Swiss borrowers took 17% of this sector of the market in November and December. US borrowers accounted for 11% of convertibles and 6% of warrants issues.

**Announced international bond issues**[a]

$ billions; *percentages in italics*

| | 1984 | 1985 | | 1986 | | | |
|---|---|---|---|---|---|---|---|
| | Year | Year | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Fixed-rate bonds** | | | | | | | |
| Borrower: | | | | | | | |
| Major OECD countries | 46.8 | 70.5 | 20.1 | 31.2 | 34.6 | 26.0 | 23.8 |
| of which: | | | | | | | |
| United States | 20.0 | 30.2 | 9.0 | 11.0 | 10.3 | 6.5 | 3.4 |
| Japan | 14.4 | 19.0 | 4.1 | 5.8 | 8.5 | 8.3 | 8.6 |
| Minor OECD countries | 12.8 | 18.4 | 5.6 | 9.5 | 7.6 | 8.7 | 11.5 |
| International institutions | 12.4 | 15.7 | 4.1 | 5.5 | 3.5 | 3.9 | 4.2 |
| Other | 2.0 | 2.8 | 0.4 | 1.0 | 0.4 | 0.7 | 0.3 |
| **Total** | **74.0** | **107.4** | **30.2** | **47.2** | **46.3** | **39.3** | **39.8** |
| Currency: | | | | | | | |
| US dollars | *50.1* | *46.8* | *44.4* | *46.9* | *50.3* | *43.8* | *49.5* |
| Swiss francs | *17.4* | *13.7* | *18.5* | *13.1* | *10.6* | *15.5* | *15.1* |
| Yen | *8.0* | *11.3* | *11.6* | *15.9* | *7.7* | *14.9* | *12.3* |
| Other | *24.5* | *28.2* | *25.5* | *24.1* | *31.4* | *25.8* | *23.1* |
| **Floating-rate notes** | | | | | | | |
| Borrower: | | | | | | | |
| Major OECD | 21.6 | 38.6 | 11.5 | 5.4 | 7.0 | 15.0 | 6.6 |
| Minor OECD | 9.6 | 8.1 | 1.1 | 1.6 | 1.4 | 5.7 | 2.0 |
| Other | 2.8 | 8.6 | 1.8 | 1.4 | 0.9 | 0.1 | 0.7 |
| **Total** | **34.0** | **55.3** | **14.4** | **8.4** | **9.3** | **20.8** | **9.3** |

(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 volume of issues denominated in dollars fell by $1.6 billion to $12.2 billion, although the dollar's share of a reduced market rose from 45% to 50%. Demand for dollar-denominated bonds in the latter part of the year was particularly affected by uncertainty over the future path of the dollar exchange rate. The volume of new issues denominated in Swiss francs fell from Sw. Fc. 9.7 billion to Sw. Fc. 4.9 billion, and the Swiss franc's market share fell from 18% to 12%. Sterling issues totalled £243 million, or slightly over 1% of the market. The yen's market share remained at 14%. There were only two dual-currency issues (both in yen).

**Floating-rate notes**

There was a sharp decline in the FRN market in November and December; new issues amounted to only $4.7 billion, compared with $13.5 billion in the previous two months. US borrowers accounted for $2.6 billion, or 55% of the total. UK borrowing amounted to $1.6 billion.

Issues by banks fell from $4.2 billion in September and October to $1.6 billion. There was no sovereign borrowing in the FRN market in November and December, whereas there had been $5.2 billion of sovereign issues in September and October.

In December there were three issues of collateralised mortgage obligations (CMOs), or mortgage-backed FRNs, amounting to $650 million. Unlike most previous issues of mortgage-backed FRNs, CMOs are not issued by US savings and loans institutions using mortgages as collateral, but are put together by US investment banks and work the same way as pass-through securities: a bundle of US residential mortgages is held in a trust and the payments received on the mortgages are passed through to the FRN investors.

Issues of perpetual FRNs amounted to $1.5 billion. This represents a slight increase on the total for September and October, but there was only one perpetual issue after the perpetual market temporarily ceased trading on 3 December, and that issue has a put option for invety-five years.

Issues of perpetual FRNs had risen sharply during the autumn with $1 billion of new issues in both October and November, compared with under $1 billion per quarter in the first half of the year. At the same time, spreads had become narrower. By the end of November, investors were apparently beginning to feel that at these levels spreads were out of line with the underlying nature of the instrument. The sudden fall in prices that occurred in the first days of December, however, seems to have been triggered by a story that Japanese banks might be permitted to issue perpetual FRNs to increase their capital base: this would increase the supply of perpetual FRNs and, it was thought, would reduce the demand, as it was assumed that at the same time Japanese banks' holdings of other banks' subordinated debt would be deducted from their own capital (as is done in the United Kingdom).

The attractions of perpetual FRNs for investors had lain in the combination of a relatively high spread with a liquid market. The spreads subsequently available looked unattractive beside those available on newer instruments such as FRNs backed by US mortgages; with the end of the year approaching, market makers were unwilling to build up long positions and liquidity started to dry up. In these circumstances, the market experienced severe difficulties, and on the morning of 3 December the prices of perpetual FRNs collapsed, losing 2% or more. By mid-morning trading of perpetual FRNs had stopped. (Other FRNs were barely affected, however.) The market partly reopened afterwards, but trading remained thin and prices weak.

The proportion of FRN issues in November and December denominated in dollars rose from 88% to 92%. There were no sterling FRN issues in the period.

**Euronote 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 November and December fell $3.1 billion from the previous two months' notably high total to $11.2 billion. The proportion of facilities which were non-underwritten or uncommitted fell from 85% to 80% (by value).

The eurocommercial paper market, which forms the greater part of the uncommitted euronote market, dominated the market throughout 1986. Uncommitted facilities formed 78% of the market, and by the end of the year the ECP market was attracting a greater diversity of borrowers: for example, a $300 million ECP programme was arranged in November for the Bank of Greece.

**Announced euronote facilities[(a)]**

$ billions

| | 1984 | 1985 | | | 1986 | | | |
|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Committed(b) | 18.20 | 33.14 | 5.01 | 8.49 | 3.41 | 6.01 | 2.52 | 3.37 |
| Uncommitted | 0.64 | 16.35 | 2.96 | 9.75 | 10.72 | 14.39 | 14.81 | 14.36 |
| **Total** | **18.84** | **49.49** | **7.97** | **18.24** | **14.13** | **20.40** | **17.33** | **17.73** |
| *of which:* | | | | | | | | |
| *Major OECD* | *6.40* | *29.26* | *4.22* | *10.62* | *8.10* | *13.06* | *11.71* | *10.59* |
| *Minor OECD* | *11.20* | *17.55* | *3.34* | *6.94* | *5.43* | *6.22* | *5.37* | *6.69* |
| *Other* | *1.24* | *2.68* | *0.41* | *0.68* | *0.60* | *1.12* | *0.25* | *0.45* |
| **Selected nationalities of borrower** | | | | | | | | |
| United States | 3.16 | 17.48 | 1.84 | 5.88 | 2.08 | 5.98 | 5.19 | 5.15 |
| France | 1.24 | 2.99 | 0.58 | 0.70 | 1.25 | 0.94 | 1.40 | 0.93 |
| United Kingdom | 0.72 | 3.82 | 1.00 | 1.92 | 0.08 | 1.23 | 0.70 | 0.50 |
| Australia | 2.72 | 7.90 | 1.68 | 3.96 | 1.17 | 1.90 | 0.50 | 3.30 |
| Sweden | 4.72 | 4.82 | 1.20 | 0.32 | 1.25 | 0.75 | 1.00 | 1.35 |

(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.

Nearly all facilities ($9.8 billion, or 96% of the total) were denominated in dollars, with the remainder comprising facilities denominated in ECU, Singapore dollars and Norwegian kroner.

The euronote market continued to be very largely the preserve of OECD borrowers, with only four facilities in November and December being arranged for non-OECD borrowers. Facilities for US borrowers amounted to $3.0 billion, compared with $4.0 billion in September and October, while facilities arranged for Australian borrowers doubled, to $2.5 billion. Swedish borrowers were also active in the market, with a total of $1.4 billion.

The Australian and Swedish totals each contain a medium-term note (MTN) programme: one such programme was included in a $1 billion facility for the Australian Industry Development Corporation, and a $500 million MTN programme was arranged for Volvo of Sweden.

There continued to be a reduction in fees on euronote facilities for top borrowers, to very low levels. A $200 million deal for a French borrower, Rhône Poulenc, included a facility fee of four basis points, while a $315 million facility for Renfe of Spain carried a split facility fee of 2½ basis points rising to 3 basis points.

**Eurocurrency syndicated lending**

The total value of syndicated credits announced in November and December was $6.1 billion. This was slightly less than in the previous two months, and activity in the credits market remains small in comparison with the fixed-rate bond and euronote sectors of the international capital markets. Dollar credits amounted to $5.0 billion, or 86% of the total.

**Announced eurocurrency syndicated credits**

$ billions

| | 1984 | 1985 | | | 1986 | | | |
|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Major OECD | 9.90 | 5.06 | 1.10 | 1.43 | 2.21 | 2.02 | 2.02 | 5.29 |
| Minor OECD | 6.16 | 4.40 | 0.86 | 0.49 | 1.38 | 0.98 | 2.15 | 1.98 |
| Developing countries | 7.17 | 3.92 | 1.29 | 0.48 | 1.28 | 0.68 | 1.58 | 0.96 |
| Eastern bloc | 2.19 | 3.55 | 0.71 | 0.61 | 0.50 | 1.13 | 0.21 | 0.50 |
| Other | 4.69 | 1.99 | 0.54 | 0.24 | 1.64 | 1.19 | 0.61 | 1.37 |
| **Total** | **30.11** | **18.92** | **4.50** | **3.25** | **7.01** | **6.00** | **6.57** | **10.10** |
| *of which, transferable* | *1.49* | *5.77* | *1.62* | *0.16* | *1.75* | *1.05* | *0.10* | *0.44* |

Most borrowers continued to achieve finer terms on syndicated credits. An exception was Algeria, however, which returned to the market in November in the shape of the Banque Nationale d'Algérie with a $250 million loan, but, at ⅞% over Libor, was faced with higher spreads on its borrowings than it had previously been able to obtain. Greece had experienced a worsening of terms on some small loans in the first half of 1986, after doubts had emerged concerning the success of economic adjustment measures initiated in October 1985, but terms subsequently improved (for example, a spread of ⅝% over Libor was achieved on a £100 million credit in December).

Among OECD countries there were several small credits for Italian borrowers, amounting to $750 million, and French borrowing doubled, to $1.1 billion. Total US borrowing in November and December was $1.3 billion.

## International banking developments

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

**Banks in the BIS reporting area** (third quarter of 1986)

The expansion of BIS-area banks' cross-border lending in the third quarter was the largest ever recorded in a single quarter. The $167 billion (6%) increase took the total cross-border assets of reporting banks to $3,000 billion at end-September. Nearly 95% of this growth was due to interbank business between reporting banks, dominated by Japanese banks. Much of this activity was affected by mid-financial-year window-dressing operations of the Japanese financial and corporate sectors. However, there are also thought to be non-seasonal factors behind this growth. These include the financing of a larger proportion of the US current account deficit through the interbank market; banks' acquisition of securities inventories funded in the interbank market; and increasing competition between Japanese banks over the size of their balance sheets. As regards the currency composition of the growth in assets, around 70% of the growth was in dollar assets and around 20% in yen.

Complementing the record growth in cross-border lending in the third quarter, there was a record rise of $89 billion in foreign currency lending to residents, mainly by banks in Japan.

The expansion of international banking business was centred mainly in the United Kingdom, Japan and to a lesser extent Belgium. In the European centres the pronounced increase in external claims was largely accounted for by Japanese banks transferring funds back to banks in Japan.

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

$ billions; changes exclude estimated exchange rate effects

| | 1984 | 1985 | 1986 | | | Out-standing at end-Sept. |
|---|---|---|---|---|---|---|
| | Year | Year | Q1 | Q2 | Q3 | 1986 |
| **Liabilities vis-à-vis:** | | | | | | |
| BIS reporting area(a) | 98.6 | 178.5 | 35.8 | 47.2 | 122.8 | 1,924.2 |
| 'Offshore' centres | 23.4 | 43.7 | 5.5 | 16.8 | 53.9 | 516.6 |
| Sub-total | 121.9 | 222.1 | 41.3 | 64.0 | 176.6 | 2,440.8 |
| Outside reporting area | | | | | | |
| Developed countries | 3.2 | 3.1 | - 0.5 | 1.1 | 3.2 | 41.2 |
| Eastern Europe | 4.3 | 2.7 | - 1.1 | 0.1 | - 0.7 | 27.6 |
| Oil exporters(b) | 2.2 | 7.5 | - 6.9 | - 7.4 | - 2.9 | 148.3 |
| Non-oil developing countries | 19.6 | 5.4 | - 2.2 | 1.9 | 4.4 | 188.0 |
| *of which, Latin America* | *10.2* | *0.4* | *0.6* | *- 0.3* | *- 1.5* | *69.2* |
| Sub-total | 29.5 | 18.7 | - 10.7 | - 4.3 | 4.0 | 405.2 |
| Unallocated(c)(d) | 0.3 | 0.7 | 6.1 | 4.0 | 9.5 | 101.5 |
| **Total** | **151.6** | **241.5** | **36.6** | **63.7** | **190.1** | **2,947.5** |
| **Assets(e) vis-à-vis:** | | | | | | |
| BIS reporting area(a) | 91.7 | 181.0 | 35.8 | 43.4 | 127.1 | 1,805.0 |
| 'Offshore' centres | 21.8 | 24.1 | - 1.0 | 22.3 | 37.3 | 474.3 |
| Sub-total | 113.5 | 205.2 | 34.8 | 65.7 | 164.4 | 2,279.3 |
| Outside reporting area | | | | | | |
| Developed countries | 5.6 | 6.8 | - 0.5 | 1.7 | 0.2 | 110.2 |
| Eastern Europe | — | 5.6 | - 0.3 | 2.7 | 0.7 | 70.9 |
| Oil exporters(b) | - 1.8 | 0.1 | - 3.4 | 0.6 | 1.7 | 115.2 |
| Non-oil developing countries | 10.5 | 10.8 | - 4.7 | — | 0.1 | 360.2 |
| *of which, Latin America* | *5.4* | *1.6* | *- 2.2* | *- 0.1* | *- 0.8* | *220.1* |
| Sub-total | 14.2 | 23.2 | - 8.9 | 5.0 | 2.7 | 656.5 |
| Unallocated(c) | — | 3.8 | 1.6 | 1.8 | 0.2 | 64.0 |
| **Total** | **127.7** | **232.2** | **27.4** | **72.4** | **167.3** | **2,999.8** |

(a) Excluding 'offshore' centres.
(b) OPEC plus Oman, Brunei and Trinidad and Tobago.
(c) Includes international institutions.
(d) From the first quarter of 1986 includes capital issues in foreign currencies by banks in Ireland, Sweden and the United Kingdom.
(e) From the first quarter of 1986 includes international securities held by banks in the United Kingdom.

Lending to non-bank final users, net of redepositing of funds between the reporting banks (but allowing for the banks' own use of external funds for domestic lending), was estimated to have risen by $55 billion (a 3% increase). This lending rose $110 billion in the first nine months of 1986 compared with $60 billion in the same period in 1985. The strong growth in lending in the third quarter was almost entirely absorbed within the reporting area ($52 billion). The United States and the United Kingdom were the largest takers of new funds. On the sources side of the market, the reporting area remained the major supplier of new funds; non-bank deposits grew particularly strongly.

Lending to countries outside the reporting area rose by under $3 billion (an increase of under half a per cent). With deposits by this group of countries rising by $4 billion, the outside-area countries were small net suppliers of new funds.

There were few signs of spontaneous lending to problem debtor countries. Claims on Latin America fell by $0.8 billion (this contraction was influenced, according to the BIS, by banks writing down the book value of claims, debt/equity swaps and transfers of claims to export credit insurance agencies). These countries also had to draw down their deposits with reporting banks (which fell by $1.5 billion). The largest drawdown of deposits was among OPEC countries, whose deposits fell by nearly $3 billion, bringing the cumulative drawdown over the first nine months of 1986 to over $17 billion (a fall of around 10%).

The increase in deposits by non-OPEC developing countries owed most to Taiwan, whose deposits rose by $5 billion (bringing the cumulative rise in their deposits during the first nine months to over $9 billion). Among Eastern European countries, the Soviet Union raised $1.3 billion.

The most recent half-yearly maturity analysis (end-June 1986) of the consolidated claims of banks in the BIS reporting area shows lengthening maturities for all country groupings. This is particularly pronounced for Latin America, as a result of debt rescheduling. The proportion of banks' claims on outside-area countries with maturities of over two years expanded to 46.3%, compared with 43.2% at end-December 1985. Undisbursed commitments increased only modestly after a sizable rise in the second half of 1985.

A more comprehensive measure of external indebtedness, covering both bank and trade-related non-bank claims, is prepared jointly by the BIS and the OECD. The current dollar value of these claims rose 3% over the six months to end-June 1986. The proportion of banks' lending to debtor countries which has been officially guaranteed or insured fell back slightly to 10.5% at end-June, compared with 10.8% at end-1985.

**The London market** (fourth quarter of 1986)
In the fourth quarter, the growth in cross-border lending by banks in the United Kingdom slowed to 2% (after the exceptional growth in the third quarter reflected in the BIS figures discussed above.) This increase was largely accounted for by Japanese banks who would normally be expected to unwind their end-September balance sheet buildup in this quarter; at the end of the fourth quarter they had a 40% share of total cross-border lending. Cross-border lending by American banks fell back; at the end of the quarter their share stood at 13%. There was a 2% fall in interbank lending within the United Kingdom, which was largely attributable to the Japanese banks.

On the funding side of the market, there was a 2% increase in cross-border deposits. The growth of these deposits with Japanese banks was to some extent offset by withdrawals from British and American banks (the latter were affected by withdrawals of deposits by their own offices overseas).

## Foreign exchange and gold markets

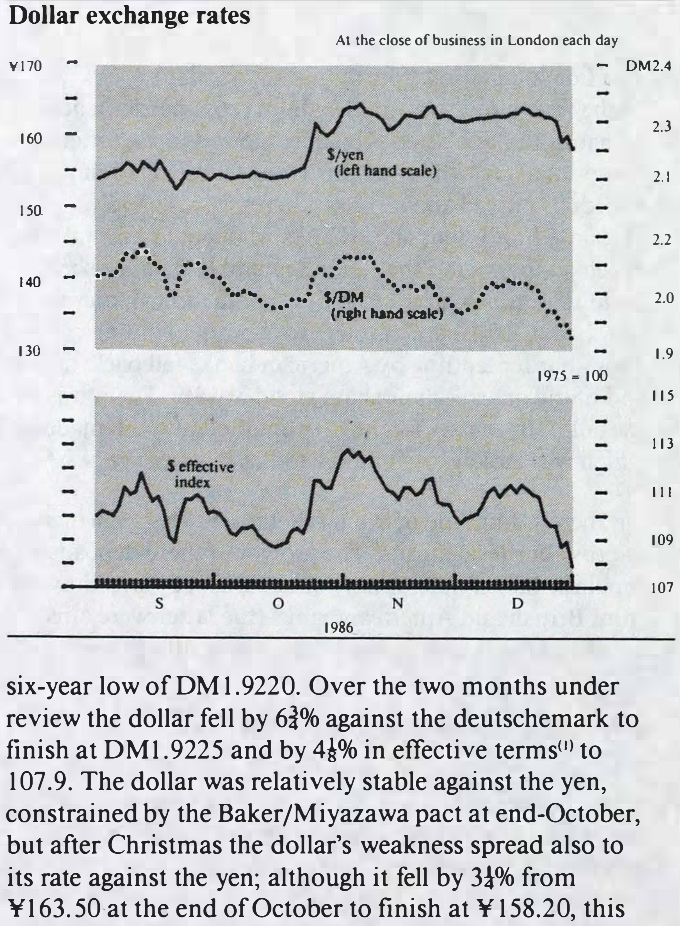
*This section reviews the two months to end-December*
Over the two months of November and December the dollar fell back sharply against Continental currencies, reflecting disappointing economic indicators and political nervousness over the Iran situation. The dollar's weakness against the deutschemark in particular brought pressure on the EMS, and the system became fully stretched by the end of the period, with the deutschemark at the top and the Danish krone at the bottom.

### US dollar

The dollar fell sharply in November on concern about the continued sluggishness of the economy, notably following the release of data suggesting weak retail sales and durable goods orders. Sentiment was also influenced by increasing political uncertainty over the Iranian arms sales affair. Although the market was cautious about provoking intervention by the Bundesbank, the key DM2 level was breached on 25 November and a new low of DM1.9575 followed on 1 December. Some good economic news, in the form of better-than-expected leading indicators and employment data and the positive effects of increased oil prices, helped the dollar to rally above DM2 in the thinnish markets of early and mid-December. The dollar's improvement was helped by good commercial and end-year demand and was also influenced by supportive comments from US officials about the exchange rate and some reassurance from the President about the Iranian arms sales affair.

However, the deutschemark strengthened before Christmas, pessimism about the US economy increased and questions arose about the Administration's ability to resist protectionist measures. As dealers squared their books, the dollar fell sharply over the run-up to New Year, and particularly on New Year's Eve after the release of very poor November trade figures, when it touched a

**Dollar exchange rates**




six-year low of DM1.9220. Over the two months under review the dollar fell by 6¾% against the deutschemark to finish at DM1.9225 and by 4⅛% in effective terms[1] to 107.9. The dollar was relatively stable against the yen, constrained by the Baker/Miyazawa pact at end-October, but after Christmas the dollar's weakness spread also to its rate against the yen; although it fell by 3¼% from ¥163.50 at the end of October to finish at ¥158.20, this was some 3% above the early-October low. From the close of business in New York on 20 September 1985, just before the G5 Plaza meeting, the dollar depreciated by 32¼% against the deutschemark, 33¾% against the yen and 22¾% in effective terms.

### EMS

The EMS narrow band widened in November but remained broadly within 2%, with the deutschemark remaining at the top and the Danish krone replacing the Belgian franc at the bottom in early November. Tensions developed in the second half of December and the narrow band widened before Christmas to near its limit. The deutschemark strengthened, in part benefiting from the dollar/yen stabilisation, but also reflecting the inherent strength of the balance of payments and the diminishing likelihood of a cut in German interest rates. The Danish krone fell back, in part reflecting uncertainty in the market about the Danish external balance; and the French franc was affected by the domestic political and industrial situation. Although the French seven-day repurchase rate was increased termporarily by 1% to 8½% on 8 December, pressure on the franc re-emerged and it moved down sharply into the lower half of the narrow band in the second half of the month, finishing at 1⅝% below the deutschemark. The lira eased over the period to 7/16% above the mark and the Irish pound fell to 1⅝% below the mark. The Belgian franc also fell back, to 1 15/16% below the mark.

### Other currencies

For most of the period the yen was relatively stable against the dollar and both fell back against the strong deutschemark until late December, when the yen broke free from the dollar and steadied against the deutschemark. The deutschemark/yen rate strengthened over the period by 3¾% to 82.29, close to its 1986 high. The yen's effective rate rose over the period by ½% to 207.3, in part reflecting a rise of 3¼% against the dollar.

The Swiss franc fluctuated in November, but strengthened overall against the dollar, and rose in effective terms by 2⅛% to 168.2. It fell back in early December as the dollar improved but later picked up to end December at Sw. Fc. 1.6115, an improvement of 6% over the two months. In effective terms it ended December at 168.6, little changed over the month but an increase of 2⅜% over the two-month period.

The Norwegian krone fluctuated nervously in November against a background of uncertainties about the government's budget and economic programme for 1987 and a large deficit on the external current account. It depreciated over November by 2% in effective terms to 76.5 but improved marginally against the dollar. Although economic concerns persisted in December, the Norwegian krone's value improved by ½% in effective terms over the month as a whole, helped by an increase in interest rates. It finished December at 77.0 in effective terms, down 1⅜% over the two months, and at N Kr 7.3475, up 2¼%, against the dollar.

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

**Gold**

Gold moved broadly in reaction to changes in the dollar and in platinum and, to a lesser extent, oil prices. Gold rose early in November when the dollar eased, reaching $410.75 on 10 November, but fell back sharply as platinum prices weakened further, falling to $380.40 on 24 November, before picking up to $390 at the end of the month. The first December fix was a peak for the month of $399.60, after which gold remained relatively stable—it rose slightly in mid-December as oil prices increased and finished the month at $390.90, down $10.10.