

# International financial developments

Among the main developments:

- The US current account deficit is estimated to have narrowed slightly in the first quarter of 1987—the first decrease since the autumn of 1985—reflecting further strengthening in export volumes: however, the Japanese and German surpluses both rose further, so that imbalances among the three major economies were little changed.
- Activity in the capital markets fell back in the second quarter from the high level of the previous three months, with a sharp decline in fixed-rate bond issues (other than equity-related issues) and continuing weakness in the floating-rate sector.
- After the exceptional surge in international bank lending in the second half of 1986, the growth in new lending slowed in the first quarter of 1987. This slowdown stemmed mainly from a sharp contraction in interbank business involving banks in Japan and in the United States.
- In the foreign exchange markets, the dollar weakened further in April and early May but recovered thereafter, to end the quarter marginally higher in effective terms, on growing market optimism about the effectiveness of measures agreed by the G7 to stabilise exchange rates.

## Balance of payments positions

The combined current account position of the *OECD economies* and imbalances among the three largest economies are estimated to have been little changed in the first quarter of 1987. The US deficit narrowed for the first time since the third quarter of 1985 as export volumes continued to pick up, but the Japanese and German surpluses increased slightly in dollar terms. Among the other major countries, the French and Italian current account positions are estimated to have deteriorated markedly; in France's case this largely reflected a further worsening in the balance on manufacturing trade.

Almost a quarter of the US current account deficit in 1986 was covered by an increase in US liabilities to the central monetary authorities of other industrial countries. In the first quarter of this year, total official purchases of dollars rose still further and intervention financed nearly 40% of the US current account deficit. Other notable features of capital flows in 1986 also continued into the first quarter of 1987. Germany's capital account was characterised by substantial net long-term inflows and net short-term capital outflows through the banks. In contrast to German banks, Japanese banks continued to 'borrow short' in order to 'lend long'. Within the portfolio account, Japanese residents' net acquisition of foreign equities increased in the first quarter while that of foreign bonds continued to ease. Japanese gross direct investment outflows remained large in the first quarter, but were slightly down on the records of the preceding two quarters, which may have been boosted by the effects of impending tax reform in the United States.

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

\$ billions; seasonally adjusted

	1985	1986	1986(b)				1987(b)
	Year	Year	Q1	Q2	Q3	Q4	Q1
OECD economies:							
Canada	—	- 6	- 2	- 1	- 1	- 2	- 2
France	—	4	—	1	1	2	—
Germany	15	36	8	8	11	9	11
Italy	- 4	4	- 1	1	3	2	- 1
Japan	49	86	16	22	24	24	25
United Kingdom	4	- 2	1	—	- 1	- 1	1
United States	-118	-141	-34	-34	-35	-38	-37
Major economies	- 53	- 20	-13	- 5	1	- 3	- 3
Other OECD	- 3	- 1	—	1	- 1	- 1	- 1
Total OECD	- 56	- 21	-13	- 4	—	- 4	- 4
OPEC economies	6	- 42	- 7	-11	-13	-11	- 8
Non-OPEC developing economies	- 21	- 3	- 4	- 2	2	1	3
Other economies <sup>(c)</sup>	5	4	—	—	—	3	—
World discrepancy <sup>(d)</sup>	- 66	- 62	-24	-17	-10	-12	- 8

(a) Components may not add up due to rounding.

(b) Includes Bank estimates.

(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).

Preliminary estimates indicate an increased current account surplus of around \$3 billion for the *non-OPEC developing countries* in the first quarter of 1987, reflecting a continuation of earlier trends—a steadying in the aggregate terms of trade and continued moderate export growth. In 1986 there had been a substantial narrowing in these countries' current account deficit and a fall in net capital inflows. Difficult external conditions, associated with a sharp decline in oil prices and weak primary product prices, combined with a turnaround to a net reflow to banks, necessitated further adjustment in many countries last year. The strength and pattern of adjustment varied, however, so that although the group as a whole

## Non-OPEC developing countries' balance of payments

\$ billions; not seasonally adjusted

	1985	1986(a)	1985				1986(a)			
	Year	Year	Q4	Q1	Q2	Q3	Q4	Q4	Q4	
<b>Current account</b>	-21	-2	-6	-4	1	2	-1			
<b>Capital account</b>	23	18	10	—	3	4	11			
<i>of which:</i>										
Concessionary and other financial flows	21	20	5	5	5	5	5			
Direct investment	10	10	3	3	2	2	3			
Borrowing from banks(b)	11	-1	6	-6	—	—	5			
Borrowing via bond issues (gross)	7	4	3	1	1	1	1			
Other capital flows(c)	-26	-15	-7	-3	-5	-4	-4			
<b>Official financing balance</b>	<b>1</b>	<b>16</b>	<b>4</b>	<b>-4</b>	<b>4</b>	<b>6</b>	<b>10</b>			
<i>of which:</i>										
Use of IMF credit	1	-1	—	—	-1	—	—			
Liabilities to other CMIs	—	—	—	—	—	—	—			
Reserves etc (increase -)	-2	-15	-4	4	-3	-6	-10			

(a) Includes Bank estimates.

(b) Net; adjusted to exclude valuation effects.

(c) Including net errors and omissions.

experienced a sharp contraction in import growth (to around 1%), one or two economies experienced a surge in imports. Reserves of the group as a whole rose by \$15 billion in 1986, but this was more than accounted for by Taiwan, whose reserves rose from \$22 billion to \$46 billion.

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

\$ billions

	Mar. 1986 levels	1986			Q1(b)	Mar. 1987 levels(b)
		Q2	Q3	Q4		
<b>Industrial countries</b>						
United Kingdom:						
Sterling bank deposits	6.7	-0.5	—	-0.1	0.3	6.9
Eurocurrency bank deposits	42.1	-1.3	-2.6	-1.7	-2.6	35.6
Government paper	3.6	0.2	0.2	0.8	0.5	5.9
Other investments	8.3	—	—	0.2	0.2	9.9
	60.7	-1.6	-2.4	-0.8	-1.6	58.3
Other EEC:(c)						
Domestic currency bank deposits	4.6	0.1	0.4	-0.1	—	6.0
Eurocurrency bank deposits	21.6	-1.8	-1.0	-1.6	—	17.8
Other investments	54.1	0.4	0.2	0.8	0.4	64.7
	80.3	-1.3	-0.4	-0.9	0.4	88.5
United States:						
Bank deposits	21.7	-1.0	1.0	-1.4	-1.0	19.7
Government paper	29.5	-0.2	-2.0	-2.3	-2.3	22.8
Other investments	27.8	-1.0	-0.6	1.5	-0.4	27.3
	79.0	-2.2	-1.6	-2.2	-3.7	69.8
Other:						
Domestic currency bank deposits	4.9	-0.6	0.2	-0.7	—	4.4
Eurocurrency bank deposits	27.7	-0.7	-1.3	-1.3	—	24.6
Other investments	43.8	5.5	-6.5	0.6	-0.7	48.3
	76.4	4.2	-7.6	-1.4	-0.7	77.3
Offshore centres:						
Bank deposits	41.7	-1.8	0.9	0.8	—	41.6
Placements with Idcs	59.4	0.1	—	—	—	59.5
OEI credit to non-banks	11.7	0.4	—	0.2	0.2	12.4
IMF and IBRD(d)	35.5	—	-0.1	-0.5	0.7	37.1
<b>Total identified additions(+)/reductions (-) in deployed assets</b>	<b>444.7</b>	<b>-2.2</b>	<b>-11.2</b>	<b>-4.8</b>	<b>-4.7</b>	<b>444.5</b>
Net funds available for deployment		-9.6	-10.9	-11.0	-7.5	
<i>of which:</i>						
Net movements in external borrowing etc		1.5	1.6	0.4	-0.8	
Current balance		-11.1	-12.5	-11.4	-8.3	

... not available.

(a) The oil exporting countries covered are defined in the notes and definitions to Table 16 of the statistical annex in the February 1987 Bulletin.

(b) Provisional.

(c) Includes Spain and Portugal.

(d) Includes holdings of gold.

Oil exporting countries continued to run a large current account deficit in the first quarter, though the estimated figure of \$8.3 billion is a little below the average quarterly deficit in 1986. The partial information available for the deployment of oil exporters' funds in the quarter shows a fall accounting for over half (\$4.7 billion) of the deficit. \$3.7 billion of this represented a reduction in assets in the United States. A withdrawal from US government paper and investment (on a smaller scale) in UK government paper represented a continuing trend. Bank deposits in the United Kingdom have continued their steady fall.

## International capital markets

Activity in the international capital markets fell in the second quarter, despite an increase in the issuance of equity-related eurobonds. There were declines in issues of straight (ie non-equity-related) fixed-rate bonds, syndicated credits and FRNs. The value of new euronote facilities rose slightly.

## Fixed-rate bonds

In the three months to June the volume of fixed-rate issues fell by \$13.1 billion from the high level in the previous quarter, to \$43.9 billion, with a rise in the volume of equity-related issues being more than offset by a decline in the straight sector.

## (i) Straight fixed-rate issues

The volume of straight issues almost halved from the first quarter to \$28 billion—some \$8 billion less than the quarterly average for 1986. Investor sentiment was affected by the weakness of the dollar and falling bond prices as well as uncertainty about the world economy: dollar-denominated issues fell by \$10 billion to just \$3.2 billion and there were sharp declines in the deutschmark, ECU and Swiss franc sectors, with more modest falls in yen and sterling. Of the major currencies, only the swap-driven Australian dollar sector saw an increase (albeit modest) in the volume of new issues.

US borrowing fell by \$6.8 billion to \$3.0 billion as corporate borrowers bypassed the euromarkets in favour of the domestic bond market, where investors are much less concerned about the exchange rate risk of the dollar. Borrowing by other major nationality groups also fell: by \$2-3 billion each in the case of borrowers from France, Denmark and Germany and a more modest \$0.4 billion for UK borrowers.

## (ii) Equity-related issues

New issues in the equity-related fixed-rate sector rose by \$7.6 billion from the first quarter to a record \$15.5 billion as rising stockmarkets worldwide made the equity component attractive to bond investors. The volume of dollar issues rose by \$7.7 billion over the first quarter to \$12.1 billion (up from 55% to 78% of the total). The volume of equity-related issues in other currencies, except the Swiss franc (and the ECU), declined.

Most of this increase was in equity-related issues by Japanese borrowers, which rose by \$7.3 billion to

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

\$ billions

	1985		1986	
	Year	Year	Q1	Q2
<b>Fixed-rate bonds</b>				
Straights	96.6	146.0	49.1	28.4
Equity-related bonds	11.6	26.7	7.9	15.5
of which:				
Warrants	4.3	19.2	3.8	10.1
Convertibles	7.3	7.5	4.1	5.4
<b>Total</b>	<b>107.8</b>	<b>172.4</b>	<b>57.0</b>	<b>43.9</b>
<b>Floating-rate notes</b>	<b>55.9</b>	<b>47.8</b>	<b>2.7</b>	<b>1.7</b>

(a) Maturities of one year and over. The table includes euro and foreign issues and publicised private placements. Issues which repackage existing bond issues are not included.

\$10.7 billion (69% of the total). US borrowing rose by \$0.8 billion and there were small increases in equity-related issuance from countries such as Australia and Canada, but borrowing by UK entities fell by a third to \$0.8 billion. Some 90% of the Japanese borrowing was through bonds with equity warrants attached and only 10% was through bonds convertible into equity. For UK and US borrowers, these proportions were reversed. The equity warrants were invariably stripped from the issues for Japanese borrowers to be traded separately at prices which implied the underlying shares would need to rise by 30% or more before the warrants would be worth exercising. After the warrants were stripped off, the remaining bonds were often used as the basis for asset swaps to create floating-rate assets for banks. Issuers were able to invest the proceeds of the issues to yield more than the coupons so that they effectively paid negative interest rates.

**Announced fixed-rate bond issues: second quarter 1987**

\$ billions; percentages in italics

	Straight	Equity related
<b>Borrower:</b>		
Major OECD countries	17.5	14.2
of which:		
United States	3.0	2.0
Japan	2.8	10.7
Minor OECD	6.1	1.3
International institutions	4.3	—
Other	0.5	—
<b>Total</b>	<b>28.4</b>	<b>15.5</b>
<b>Currency:</b>		
US dollars	11.3	77.8
Swiss francs	10.6	10.9
Yen	29.7	0.6
Sterling	9.4	8.4
Australian dollars	11.1	—
Other	27.9	2.3

**Floating-rate notes**

Announcements of FRN issues fell further in the second quarter to \$1.7 billion, compared with \$2.7 billion and \$9.3 billion respectively in the two previous quarters. As in the first quarter, investor caution has meant that all new issues have been priced above LIBOR. Many of the issues made in the period had unusual structures, such as mortgage backing, or were bonds repackaged via currency or interest rate swaps.

There were a few sovereign borrowers, including Portugal, Italy and Colombia. The Colombian issue was only the second eurobond issue by a Latin American country since 1982.

The proportion of FRNs denominated in dollars rose a little from the previous quarter but, at 65%, was well below the average of recent years. There was a single large issue in sterling—a mortgage-backed FRN worth £150 million (\$250 million); two issues in yen totalling ¥20 billion (\$138 million); and a single, sovereign, issue (by Portugal) denominated in French francs which was worth F.Fc. 700 million (\$115 million).

**Euronotes and other facilities**

The total value of euronote facilities announced in the second quarter of 1987 was \$17.8 billion, compared with a total of \$15.5 billion in the previous quarter and \$69.6 billion for 1986 as a whole. As was the case in the previous quarter, almost all (97%) of the new facilities were uncommitted. The rise in the share of uncommitted facilities since end-1985 (the uncommitted proportion was 73% in the first half of 1986 and 83% in the second) indicates borrowers' preference for arrangements that allow them to market their paper directly. This trend has been particularly evident in the recent development of the eurocommercial paper market. This instrument has accounted for 67% of euronote facilities announced so far this year compared with 47% in the second half of 1986.

Medium-term note facilities (which allow for notes to be issued in a similar fashion to eurocommercial paper but for longer terms) were introduced to the euromarkets in 1986 to fill a perceived gap between short-term financing and the eurobond market, but have so far developed more slowly than eurocommercial paper. In the first half of the year only six medium-term note programmes (totalling \$2.5 billion) were announced, including a \$1 billion facility for GMAC in April. Noteworthy was the fact that issuers may be becoming more interested in this type of financing as several conventional eurocommercial paper programmes were recently expanded to include MTN options. These combined ECP/EMTN facilities brought the total number of medium-term note facilities announced since the introduction of the instrument in the euromarkets to just under 30.

The small number of issuers, the lack of a consensus by issuers and promoters of the instrument on whether it should be primarily a placing or a trading instrument, and the lack of a dominant structure under which MTNs are issued have so far hindered the development of a more liquid market; and this has limited the interest of investors in MTNs. Investors' uncertainty over the dollar's exchange rate and expectations of higher US interest rates have reduced the attractiveness to investors of fixed-rate dollar-denominated debt instruments for the time being. This may, however, provide a niche in the market for a shorter-dated product such as MTNs. In addition, the eventual emergence of more standardised issuing methods and the entry of a greater number of large or well-known borrowers could also add to the instrument's liquidity and allay investors' concerns.

Since the inception of the market, euronote issuance has been the almost exclusive preserve of borrowers in OECD

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

\$ billions

	1985		1986			1987	
	Year	Year	Q2	Q3	Q4	Q1	Q2
Committed(b)	33.14	15.31	6.01	2.52	3.37	0.68	0.46
Uncommitted	16.35	54.28	14.39	14.81	14.36	14.79	17.32
<b>Total</b>	<b>49.49</b>	<b>69.59</b>	<b>20.40</b>	<b>17.33</b>	<b>17.73</b>	<b>15.47</b>	<b>17.78</b>
<i>of which:</i>							
Major OECD	29.26	43.46	13.06	11.71	10.59	9.60	12.49
Minor OECD	17.55	23.71	6.22	5.37	6.69	5.65	5.03
Other	2.68	2.42	1.12	0.25	0.45	0.22	0.26
<b>Selected nationalities of borrower</b>							
United States	17.48	18.40	5.98	5.19	5.15	2.39	4.59
United Kingdom	3.82	2.51	1.23	0.70	0.50	4.15	1.32
Australia	7.90	6.87	1.90	0.50	3.30	2.26	2.17
Japan	0.47	10.38	3.95	1.43	1.75	0.59	4.43

(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, eurocommercial paper programmes and medium-term note programmes).

(b) Underwritten or otherwise backed by bank commitments.

countries (close to 99% in the first half of the year). Within this group of countries, US borrowers continued to be the most active, having announced so far this year 35 dollar-denominated facilities worth \$7 billion (21% of the \$33.3 billion total), with industrial companies and financing subsidiaries the most prominent.

UK borrowers were the second most active group in the first half of 1987 with \$5.5 billion (17% of the total) in 22 announced arrangements. About half of the facilities were arranged in US dollars, 36% in sterling (often in conjunction with sterling commercial paper programmes or as part of multi-currency options) and the remainder in ECU. In contrast to US participants, UK borrowers were mainly financial institutions (60% of the total in the first half of the year).

Japanese institutions arranged 10 facilities totalling \$5 billion in the first half of 1987 (15% of the total) with a pattern of a few large deals concluded almost entirely by banks, and largely in US dollars. Lastly, Australian borrowers tapped the euronotes market with 41 deals totalling US\$4.4 billion (or 13% of the total so far this year). The financings included a fairly substantial representation (26%) by various state bodies. Of the 41 facilities, 23 (worth US\$1.3 billion) were denominated in Australian dollars.

**Eurocurrency syndicated lending**

The aggregate value of syndicated credits announced during the second quarter was \$14.5 billion, compared with \$17.7 billion (including a \$5 billion credit for BP) in the previous three months and \$29.8 billion in the whole of 1985 and 1986. In contrast to the recent downward trend in borrowing in the euromarkets generally, syndicated credits have experienced a moderate recovery from the low levels of 1986. Some of this financing might have been a substitute for eurobond issues, as the fall in the US dollar, the uncertain outlook for dollar interest rates and continuing concerns over foreign exchange stability have inhibited issues of straight eurobonds.

Most of the increase in announced syndicated credits in 1987 has been accounted for by borrowers in OECD

countries. UK borrowers have so far this year stepped up their arrangement of new credits to \$8.9 billion, or 28% of total funds raised in this market, principally as a result of the \$5 billion BP deal; this compares with \$1.2 billion (4% of the total) in 1986. US entities raised \$2.5 billion in the quarter, bringing the total to \$5.3 billion so far this year (16% of total announced financings in 1987, compared with 13% in 1986). Borrowers from Ireland and China were the next most active participants, accounting respectively for \$1.7 billion and \$1.6 billion so far this year. Funding by various Chinese organisations was substantially higher in the second quarter (\$1.3 billion as against \$0.3 billion in the first quarter), and demonstrated an increased tendency to arrange relatively large deals (\$150-200 million) in contrast to a previous pattern of numerous small deals scattered throughout the year.

Most of the new credits have been arranged for industrial concerns, which accounted for \$22.1 billion in facilities

**Announced eurocurrency syndicated credits**

\$ billions

	1985		1986			1987	
	Year	Year	Q2	Q3	Q4	Q1	Q2
Major OECD	5.06	11.61	2.02	2.02	5.36	9.55	7.29
Minor OECD	4.40	6.49	0.98	2.15	1.98	4.92	3.27
Developing countries	3.92	4.50	0.68	1.58	0.96	1.60	1.18
Eastern bloc	3.55	2.34	1.13	0.21	0.50	0.78	0.95
Other	1.99	4.81	1.19	0.61	1.37	0.82	1.77
<b>Total</b>	<b>18.92</b>	<b>29.75</b>	<b>6.00</b>	<b>6.57</b>	<b>10.17</b>	<b>17.67</b>	<b>14.46</b>
<i>of which, transferable</i>	<i>5.77</i>	<i>3.34</i>	<i>1.05</i>	<i>0.10</i>	<i>0.44</i>	<i>0.38</i>	<i>0.71</i>

announced so far this year (69% of the total), compared with \$16.1 billion (54%) in the whole of 1986. Financial institutions raised \$7.5 billion and central governments \$2.2 billion.

**International banking developments****Banks in the BIS reporting area (first quarter of 1987)**

In the first quarter of 1987, gross external lending by BIS-area banks was \$65 billion, representing a 2% increase, compared with the exceptional growth of around 7% in the final quarter of 1986. The slowdown was largely attributable to a 75% contraction in interbank business within the reporting area. This resulted from the halving of interbank borrowing by banks in Japan following the end of the phasing-in period for Tokyo's offshore market and the seasonal unwinding of end-year window-dressing operations by banks in Europe. There was also an \$18 billion contraction of interbank claims involving banks in the United States.

In terms of the currency composition of external lending, the main feature of the first quarter was a \$19 billion contraction in dollar-denominated lending. (This was more than accounted for by the \$30 billion reduction in the dollar-denominated external claims of banks in the United States.) Yen-denominated lending accounted for almost half of new lending while deutschemark lending accounted for over a quarter. The January EMS realignment helped boost ECU lending, which accounted for nearly 10% of new lending.

Developments in individual market centres were marked by a 10% growth in the external assets and liabilities of banks in Japan. Despite end-March window-dressing operations, this was a slower rate of growth than in the fourth quarter of 1986 when, owing to the opening of the Tokyo offshore market, external assets and liabilities grew by nearly 20% and 30% respectively. The growth of assets and liabilities of banks in Japan in the first quarter was broadly balanced, which contrasts with \$21 billion net external borrowing in the final quarter of last year. In contrast to this growth, the external assets and liabilities of banks in the United States contracted by 5% and 2% respectively. Banks in Germany expanded their net creditor position by nearly \$6 billion.

The BIS estimate that international lending to final users, net of redepositing funds between the reporting banks (but allowing for banks' own use of external funds for domestic lending), rose by \$60 billion (3%) in the first quarter, a similar increase to the previous two quarters.

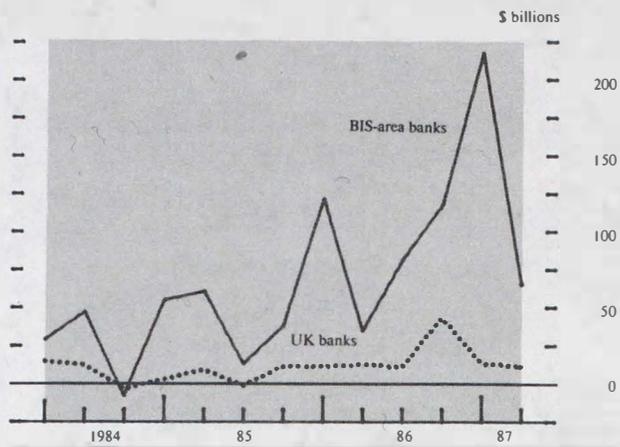
#### Cross-border business of banks in the BIS reporting area

\$ billions; changes exclude estimated exchange rate effects

	1985		1986		1987		Out-standing at end-Mar. 1987
	Year	Year	Q2	Q3	Q4	Q1	
<b>Liabilities vis-à-vis:</b>							
BIS-reporting area	176.9	383.5	52.9	127.8	161.8	61.9	2,237.9
'Offshore' centres	43.8	127.2	16.8	54.3	50.5	8.7	584.6
Sub-total	220.8	510.7	69.7	182.1	212.3	70.6	2,822.5
Outside-reporting area							
Developed countries	3.2	7.1	2.0	4.1	0.7	3.6	49.9
Eastern Europe	2.8	-0.2	0.1	-0.6	1.4	-2.0	28.5
Oil exporters	7.6	-21.9	-7.3	-2.8	-4.9	1.3	147.6
Non-oil developing countries	5.7	11.3	2.0	4.7	6.7	4.9	202.3
of which, Latin America	0.4	-0.1	-0.3	-1.4	1.1	-0.6	70.1
Sub-total	19.3	-3.7	-3.1	5.2	3.9	7.8	428.4
Unallocated	2.5	31.8	6.3	12.1	8.7	15.4	161.2
<b>Total</b>	<b>242.5</b>	<b>538.8</b>	<b>73.0</b>	<b>-199.4</b>	<b>225.0</b>	<b>93.9</b>	<b>3,412.1</b>
<b>Assets vis-à-vis:</b>							
BIS-reporting area	181.3	390.8	48.2	135.4	166.2	45.6	2,107.6
'Offshore' centres	24.3	95.4	23.3	38.6	33.6	16.7	536.4
Sub-total	205.5	486.2	71.5	174.0	199.8	62.3	2,644.0
Outside-reporting area							
Developed countries	6.8	6.5	2.1	0.8	3.8	1.2	119.7
Eastern Europe	5.7	4.2	2.7	0.6	1.2	-1.5	74.6
Oil exporters	0.2	0.2	0.8	1.7	1.0	0.7	120.1
Non-oil developing countries	11.1	0.2	0.1	0.3	4.4	-0.3	370.5
of which, Latin America	1.7	-0.9	0.3	-0.9	1.7	-0.8	224.1
Sub-total	23.8	11.1	5.7	3.3	10.5	0.1	684.9
Unallocated	4.2	14.2	4.4	0.4	7.2	2.9	90.5
<b>Total</b>	<b>233.5</b>	<b>511.5</b>	<b>81.6</b>	<b>177.7</b>	<b>217.5</b>	<b>65.3</b>	<b>3,419.4</b>

This growth took place almost entirely within the reporting area. Japanese residents were the largest borrowers; Japanese non-banks borrowed \$15 billion in foreign currency from domestic banks and \$4 billion from banks abroad. UK non-bank residents were also large takers of funds from reporting banks (\$10 billion); much of this borrowing was by non-bank financial institutions. On the funding side of the market, the non-bank sector within the reporting area accounted for around a third of deposits. US non-banks, followed by UK and German non-banks, were the most significant providers of funds. The BIS estimate that there was a substantial inflow of new funds from issues of securities by reporting banks.

#### International bank lending



Banks' lending to countries outside the BIS reporting area rose by just \$0.1 billion, the lowest quarterly increase for a year. These countries' deposits rose by \$7.8 billion, making the outside-area countries net providers of funds. New lending was largely concentrated among outside-area developed economies (notably New Zealand) and Asian countries, of which India and China were the most significant borrowers.

Claims on Eastern Europe, which was a major borrower in 1986, fell for the first time in a year. This included a 6% fall in claims on the USSR. Overall, there was also a fall in claims on Latin American countries although claims on both Argentina and Brazil rose slightly.

On the deposit side of the market, the largest increases were from developed countries outside the reporting area (notably Australia, New Zealand and South Africa) and Asian countries. The increase from Asia was almost entirely due to the increase in Taiwan's deposits, which continued to rise sharply, increasing by \$4.7 billion. OPEC's deposits, which had fallen steadily through 1986, increased slightly in the first quarter, reflecting the strengthening of oil prices.

The BIS maturity analysis of consolidated lending for the six months to the end of 1986 shows that rescheduling and new money packages lengthened the maturity structure of several developing countries' indebtedness to banks in the BIS reporting area. The proportion of public sector debt also increased for some of these countries. Undisbursed commitments declined, both absolutely and as a proportion of debt, following several major drawdowns.

**The London market** (first and second quarters of 1987) During the first quarter of 1987, UK banks' external lending was \$12 billion. This increase (2%) was broadly in line with quarterly increases in 1986 (apart from the exceptional growth experienced in the third quarter). Growth was again dominated by interbank business within the BIS reporting area. Japanese banks in London accounted for half the increase in lending. The growth in banks' holdings of overseas securities slowed to 1% (the lowest quarterly growth rate since data were first collected

from the beginning of 1986), reflecting persisting problems in the FRN market.

Japan, which was the largest net borrower from the London market last year, continued to tap London for funds in the first quarter. Lending to Japan rose by 7%. This was a slowing of the very rapid growth experienced in the second half of the last year. Most of the \$5.9 billion net lending was to other banks in Japan, but the non-bank sector in Japan was also a significant taker of funds.

The other main borrower was the United States, which in total was a net taker of \$1.8 billion; banks in the United States were net takers of \$6.5 billion, their largest borrowing in a quarter for a year, but much of this was offset by placements of \$4.7 billion in the London market from US non-banks. Non-banks in Germany were also major depositors in London in the first quarter as they were through all of last year, but Belgium, which in 1986 was a large net taker of funds, was the most significant provider of funds in the first quarter (\$4.8 billion).

Lending to countries outside the BIS reporting area, which rose gradually through most of 1986, fell by \$1.2 billion (1%) in the first quarter. This included a fall in lending to developed countries and to Eastern Europe. Both country groups had been active borrowers in 1986; for Eastern Europe this was the first fall in borrowing since the beginning of 1985. A number of Eastern European countries—notably the USSR whose deposits fell by \$1.2 billion (27%)—drew down deposits and repaid loans. Despite strengthening oil prices, oil exporters (particularly those in the Middle East) continued to draw down their deposits, which have now fallen by almost a quarter since the beginning of 1986. Lending to non-oil developing countries stagnated, but a number of Asian and Far Eastern countries were active borrowers. Taiwan's deposits increased further and have now more than doubled to \$13 billion since the beginning of 1986.

Lending to Latin America fell by \$0.5 billion (1%) and there was little activity with the major debtors. But Brazil's deposits recorded further falls and have now fallen by 70% over the last two years. Mexico's deposits rose by \$0.6 billion.

Dollar-denominated lending, which accounted for over 60% of external lending last year, fell by 2% in the first quarter. Yen-denominated lending rose sharply to account for nearly 40% of new lending in the first quarter (compared with 16% for the whole of 1986).

Deutschmark and sterling-denominated lending also showed strong growth. However, 60% of the stock of outstanding debt was still dollar denominated, with the deutschmark and the yen accounting for 11% and 9% respectively.

In the second quarter of 1987, UK banks' international lending rose by 2% as a result of increased cross-border interbank business. This was partly offset by a fall in foreign currency business with other UK banks, although

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

\$ billions; changes exclude estimated exchange rate effects

	1985		1986		1987				Out-standing at end-Mar. 1987
	Year	Year	Q2	Q3	Q4	Q1			
<b>Liabilities vis-à-vis:</b>									
BIS reporting area	39.2	67.4	6.2	36.9	12.3	14.3		516.4	
'Offshore' banking centres	4.5	10.1	2.7	7.8	-1.9	-1.6		108.0	
Sub-total	43.7	77.5	8.9	44.7	10.4	12.8		624.4	
Outside reporting area									
Developed countries	1.2	0.2	0.1	1.4	-1.0	1.0		16.0	
Eastern Europe	1.2	—	-0.4	-0.1	0.9	-1.1		7.3	
Oil exporters	1.3	-8.5	-1.8	-2.9	-1.8	-2.7		42.4	
Non-oil developing countries	-1.2	2.1	0.2	0.7	2.1	1.8		43.9	
of which, Latin America	-2.2	-0.5	-0.8	-0.3	-0.1	0.2		5.3	
Sub-total	2.5	-6.2	-1.8	-1.0	0.3	-0.9		109.6	
Unallocated	-0.7	-0.2	-0.9	-0.1	0.2	0.5		46.1	
<b>Total</b>	<b>45.5</b>	<b>71.1</b>	<b>6.2</b>	<b>43.6</b>	<b>10.8</b>	<b>12.3</b>		<b>780.1</b>	
<b>Assets(a) vis-à-vis:</b>									
BIS reporting area	29.0	68.5	3.9	36.8	13.0	11.8		491.6	
'Offshore' banking centres	-8.1	7.4	4.6	6.8	-3.3	0.2		107.5	
Sub-total	20.9	75.9	8.5	43.6	9.7	12.0		599.5	
Outside reporting area									
Developed countries	2.2	0.9	-0.3	-0.2	1.2	-0.5		36.4	
Eastern Europe	3.3	2.4	1.1	0.4	0.6	-0.4		19.3	
Oil exporters	-0.5	0.1	0.8	-0.1	0.1	-0.2		19.8	
Non-oil developing countries	2.7	-1.0	—	—	1.1	—		57.5	
of which, Latin America	1.4	—	-0.3	-0.1	0.7	-0.5		36.5	
Sub-total	7.7	2.4	1.6	0.1	2.9	-1.2		133.0	
Unallocated	2.4	3.6	1.0	0.3	1.1	0.8		15.6	
<b>Total</b>	<b>31.0</b>	<b>81.9</b>	<b>11.1</b>	<b>43.9</b>	<b>13.7</b>	<b>11.7</b>		<b>747.8</b>	

(a) Securitised lending included from the first quarter of 1986.

UK non-banks further increased their borrowing. International deposits also rose by 2%, funds coming from own offices and other banks abroad. The smaller bank groups in London provided much of the impetus behind the growth in both deposits and lending; unlike the other bank groups they expanded their domestic foreign currency business with both banks and non-banks.

Japanese banks' lending and deposit-taking in foreign currencies vis-à-vis other UK banks showed a fall greater than the usual seasonal drop from the unwinding of window-dressing, with the result that their total international lending and deposit-taking fell for the first time for two and three years, respectively. The Japanese banks did, however, like the American banks, continue to expand their business with own offices abroad. A substantial fall in issues of CDs by American banks caused a fall in the total issued by UK banks. Take-up of investments (including FRNs) fell slightly; the modest increase in Japanese purchases did not outweigh reductions among the other bank groups, including the Americans, who further reduced their already small holdings.

## Foreign exchange and gold markets

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

Over the period under review the dollar fell back to a record low against the yen and a seven-year low against the deutschmark on continuing concern about the US trade deficit and, in particular, the trade frictions between the United States and Japan. However, after early May the dollar gradually recovered as the market became

more optimistic about the success of measures agreed by the Finance Ministers of the Group of Seven (G7) to stabilise exchange rates and moderate international imbalances.

### US dollar

The dollar opened in London on 1 April at DM1.8175 and ¥146.80. The market was initially bearish on concerns that trade frictions between the United States and Japan might undermine the Louvre accord between the Group of Five countries together with Canada to stabilise exchange rates. Weaker-than-expected US employment data also contributed to the dollar's weakness.

Disappointment that the meeting of the G7 Finance Ministers in Washington on 7 and 8 April did not result in new measures to stabilise the dollar added to the downward pressure. Following the publication of a worse-than-expected US trade deficit for February of \$15 billion, the dollar touched a new low of ¥140.35 on 14 April. After a brief rally, it fell further in late April on concern that the recent growth in US GNP would not be sustained, fears of renewed inflationary pressures, and continued concern about possible US protectionist legislation, touching a record low of ¥137.25 on 27 April. The dollar steadied in advance of the summit meeting between President Reagan and Prime Minister Nakasone but touched a low for the quarter of DM1.7638 on 5 May, on comments by a US official that the talks had not been successful.

After early May, market sentiment turned in favour of the dollar and optimism grew that it had passed its trough. A number of factors contributed to this change of view: interest differentials widened; there were signs of improvement in the US trade balance; the Japanese authorities introduced a fiscal package that was more

expansionary than expected and issued guidance to Japanese banks, financial institutions and corporations asking them not to sell the dollar speculatively; high bond prices in Japan encouraged outflows into dollars; and hopes grew that the disparities in the performance of the major economies might be lessening. After a temporary set-back on 19 May following Citibank's announcement of greater loan loss provisions, the dollar rallied sharply on 26 May, touching highs of ¥144.50 and DM1.8280 on the following day. The unexpected announcement on 2 June of Mr Volcker's resignation as Chairman of the Federal Reserve Board triggered a renewed fall in the dollar but this was quickly reversed. The dollar's recovery was dampened by initial disappointment that the Venice summit did not result in new measures to promote exchange rate stability, but its upward trend soon re-emerged so that by 23 June it had recovered to touch ¥146.80 and DM1.8460. Thereafter the market's bullish mood was punctuated by fears that there might soon be co-ordinated central bank sales of dollars to moderate its appreciation. The dollar closed June at ¥146.87, up  $\frac{1}{2}\%$  on the quarter, and DM1.8265, up  $1\frac{1}{8}\%$ ; and rose in effective terms by  $\frac{7}{8}\%$  to 102.3.

### EMS

The EMS was generally free of significant pressure during the second quarter. April opened with the Irish pound at the lowest position, but it was soon replaced by the Belgian franc, which remained there for the rest of the quarter. The Danish krone occupied the highest position but eased towards the end of June on uncertainties ahead of the Danish general election expected in the autumn. The  $2\frac{1}{4}\%$  band was briefly stretched to its limit in late April as the EMS currencies adapted at varying speeds to movements in the dollar, but for the most part the system was relaxed, ending just  $1\frac{1}{8}\%$  wide.

### Yen

In April, the Japanese yen strengthened more rapidly against the dollar than did Continental currencies, reflecting the market's concern about the extent of Japan's bilateral trade surplus with the United States. Accordingly, the deutschemark eased from ¥80.94 at the end of March to ¥77.68 by 27 April. After a period of stability around ¥78.5 in May, the yen showed a more rapid decline against the dollar, with the result that the deutschemark recovered to ¥80.41 by the end of June.

### Gold

Gold opened in April at \$418.50 and initially firmed against the weakening dollar. A surge in the silver market and fears that there would be a downturn in world stock markets also helped gold initially, and by 27 April it reached \$476.60. Gold then eased as the dollar recovered, but surged briefly to a new high of \$479.95 on 20 May on news of Citicorp's loan loss provisions. Gold eased to close the quarter with a final fixing of \$447.30.

### Dollar exchange rates

