

# International financial developments

*Among the main developments:*

- *In the international capital markets, concern about interest rate trends was reflected in a sharp decline in straight fixed-rate bond issues in the third quarter, although activity in the equity-linked sector remained very strong: announcements of syndicated credits rose to levels last seen five years ago.*
- *In the second quarter of 1987, international bank lending returned to the high rate of growth experienced in the second half of last year. The new business was largely interbank, more than half of which was accounted for by banks in Japan.*
- *In the foreign exchange markets, the dollar strengthened in July and August before falling back on publication of poor trade figures: reaffirmation of their commitment to the Louvre accord by G7 ministers meeting in Washington brought a recovery towards the end of the quarter and the dollar closed the period little changed overall in effective terms.*

## Balance of payments positions

A marked strengthening in the combined current account position of the *seven major industrial countries* and a corresponding deterioration in OPEC's current account were the major features of world current account developments in 1986. Within the general strengthening of the industrial countries' current accounts, however, imbalances between the three largest economies widened sharply in dollar terms, and figures for the first half of 1987 suggest no significant improvement, though they may have stabilised. The US current account deficit exhibited a sharp increase from \$37 billion in the first quarter of this year to \$41 billion in the second, while the Japanese and German surpluses show little sign of diminishing. A deterioration in the terms of trade in the first half of this year helped push the current accounts of France, Italy and the United Kingdom into deficit, while the existing Canadian deficit has continued. The smaller European countries also appear to be heading for an aggregate current account deficit this year.

1986 was a difficult year for the *OPEC economies*, with their oil export prices over 50% lower on average than in 1985. Consequently, and despite continued significant import restraint by most countries and high export volume growth, the collective OPEC current account deficit was in excess of \$30 billion in 1986, compared with a surplus of \$5 billion in 1985. However, the recovery in oil prices over the first half of this year has brought some reduction in the deficit.

The current account position of the *non-OPEC developing countries* remained near balance in the first quarter of 1987, despite a fall in export volumes, as imports also declined and the outflow on invisibles was unchanged.

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

\$ billions; seasonally adjusted

	1985 Year	1986 Year	1986(b)			1987(b)	
			Q2	Q3	Q4	Q1	Q2
OECD economies:							
Canada	- 1	- 7	- 1	- 2	- 2	- 2	- 2
France	-	4	-	1	1	2	-2
Germany	16	38	8	12	10	11	11
Italy	- 4	5	1	4	2	-	- 3
Japan	49	86	22	24	24	25	21
United Kingdom	4	- 2	-	- 1	- 1	1	-
United States	-118	-141	-34	-35	-37	-37	-41
Major economies	- 53	- 17	- 4	3	- 3	-	-16
Other OECD	- 2	- 6	- 2	- 1	- 2	- 2	- 3
Total OECD	- 55	- 23	- 6	2	- 5	- 2	-19
OPEC economies	5	- 30	- 8	- 9	- 8	- 5	- 4
Non-OPEC developing economies	- 21	- 5	- 3	-	2	-1	1
Other economies(c)	5	3	1	1	2	1	1
World discrepancy(d)	- 66	- 55	- 16	- 6	- 9	- 7	-20

(a) Components may not add to totals because of 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).

Provisional data for the second quarter point to a recovery in export volumes combined with only limited import volume growth, leading to a seasonally-adjusted current account surplus of \$1 billion. The developing countries' terms of trade appear to have changed little in aggregate between the end of last year and mid-1987. Capital inflows are estimated to have remained at around \$7 billion in the second quarter while reserves rose by \$11 billion, after a \$6 billion rise in the previous three months: excluding Taiwan, the reserves of the group rose by \$5 billion in the second quarter, having fallen by \$2 billion in the first.

Oil exporting countries are thought to have continued to run a current account deficit in the second quarter, of \$4.4 billion. Partial information on financial transactions



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

\$ billions; not seasonally adjusted

	1985	1986	1987			
	Year	Year	Q2	Q3	Q4	Q1 Q2
<b>Current account</b>	-21	-3	—	1	-1	-1 4
<b>Capital account</b>	23	18	3	4	11	7 7
of which						
Concessionary and other financial flows	21	20	5	5	5	6 5
Direct investment	10	10	2	2	3	4 4
Borrowing from banks(b)	11	1	—	—	6	— 1
Borrowing via bond issues (gross)	7	3	1	1	—	1 —
Other capital flows(c)	-26	-16	-5	-4	-3	-4 -3
<b>Official financing balance</b>	1	16	4	5	10	7 11
of which:						
Use of IMF credit	1	-1	-1	—	—	-1 —
Liabilities to other CMIs	—	—	—	—	—	— —
Reserves etc (increase -)	-2	-15	-3	-5	-10	-6 -11

(a) Data includes Bank estimates.

(b) Net: adjusted to exclude valuation effects.

(c) Including trade credit extended by developing countries and net errors and omissions.

suggests that \$1.7 billion of this was financed by borrowing. Only a part of the available information on asset movements can yet be identified by host country. The United Kingdom appears to have seen a net increase (contrary to recent experience) of \$1.9 billion in funds deployed, comprising an increase of \$2.2 billion in bank

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

\$ billions

	June 1986 levels	1986		1987		June 1987 levels(b)
		Q3	Q4	Q1	Q2(b)	
<b>Industrial countries</b>						
United Kingdom:						
Sterling bank deposits	6.5	—	-0.1	0.3	-0.1	6.8
Eurocurrency bank deposits	41.4	-2.6	-1.7	-2.6	2.3	37.8
Government paper	4.0	0.2	0.8	0.5	-0.4	5.5
Other investments	8.4	—	0.2	0.2	0.1	11.0
	60.3	-2.4	-0.8	-1.6	1.9	61.1
Other EEC(c):						
Domestic currency bank deposits	5.0	0.4	-0.1	—	—	6.4
Eurocurrency bank deposits	20.0	-1.0	-1.6	0.8	—	18.9
Other investments	56.6	0.2	0.8	0.6	0.6	70.7
	81.6	-0.4	-0.9	1.4	0.6	96.0
United States:						
Bank deposits	21.3	0.8	-1.4	-0.7	0.7	20.7
Government paper	29.3	-2.6	-2.2	-2.3	-0.8	21.4
Other investments	26.7	-0.9	-0.8	-0.3	-0.8	23.9
	77.3	-2.7	-4.4	-3.3	-0.9	66.0
Other:						
Domestic currency bank deposits	4.7	0.2	-0.7	0.3	—	5.1
Eurocurrency bank deposits	27.1	-1.3	-1.3	2.6	—	27.3
Other investments	52.6	-6.5	0.6	-0.7	-1.7	46.4
	84.4	-7.6	-1.4	2.2	-1.7	78.8
Offshore centres:						
Bank deposits	39.8	0.9	0.8	1.7	—	43.3
Placements with Idcs	59.5	—	—	—	—	59.5
OEC credit to non-banks	12.1	—	0.2	0.2	—	12.4
IMF and IBRD(d)	35.6	-0.1	-0.4	0.7	-0.8	39.6
<b>Total identified additions(+)/reductions (-) in deployed assets</b>	<b>450.6</b>	<b>-12.3</b>	<b>-6.9</b>	<b>1.3</b>	<b>-0.9</b>	<b>456.7</b>
Net funds available for deployment		-7.4	-7.9	-4.1	-2.7	
of which:						
Net movements in external borrowing etc		1.6	0.5	0.6	1.7	
Current balance		-9.0	-8.4	-4.7	-4.4	

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.

deposits partially offset by a rundown in investments. Funds deployed in the United States have fallen, but by an amount (\$0.9 billion) which represents a slower rate of withdrawal than the substantial outflows of the previous year.

**International capital markets**

New international borrowing activity in the third quarter was slightly higher than in the second, with a sharp decline in issuance of straight fixed-rate bonds being offset by an increase in syndicated credits. New announced euronote facilities were lower than in the second quarter.

**Fixed-rate bonds**

Issues of fixed-rate bonds fell from \$43.9 billion in the second quarter to \$39.7 billion in the three months to September, a rate \$3 billion below the quarterly average for 1986. Borrowing by way of fixed-rate bonds with an equity component, already at a record level in the second quarter, rose further, but issuance of straight fixed-rate bonds fell by a fifth.

**(i) Straight fixed-rate issues**

The weakness in the markets for fixed-rate bonds apparent in the second quarter intensified in the third. The major reason for the decline in issuance appears to have been upward pressure on interest rates, yields having risen in all major currencies except the Swiss franc. In the US dollar sector, concerns about interest rates seem to have stemmed largely from the US fiscal and trade deficits, while in Germany and Japan the underlying cause appears to have been expectations of monetary tightening.

The volume of dollar issues recovered from the low second-quarter level of \$3.2 billion, but at \$7.9 billion remained well below the quarterly average for 1986. Yen straight issues fell sharply from \$8.4 billion to \$1.3 billion, as rising interest rates eroded the attraction of issues in yen to borrowers motivated by opportunities to conduct swaps. Deutschmark issues fell to \$0.7 billion, compared with \$2.4 billion in the second quarter and \$6.1 billion in the first. Only in the Swiss franc sector was issuance particularly strong, rising from \$3.1 billion to \$4.4 billion as conditions became more bearish elsewhere. Borrowers seeking longer-term funds were particularly attracted to this sector—evidenced by an average maturity of over 8 years for Swiss franc issues, compared with 5 years in US dollars and 6.2 years in deutschmarks.

**(ii) Equity-related issues**

New issues in the equity-linked sector totalled \$17 billion, some \$2 billion above the record level attained in the second quarter. As in the straight fixed-rate sector, issuance in dollars declined, to \$11.3 billion, while use of the Swiss franc increased sharply to \$3.3 billion.

Japanese borrowers continued to dominate the market, accounting for over 70% of issues. A third of Japanese issues were convertibles, compared with only 10% in the second quarter. A large proportion of these convertibles



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

\$ billions

	1985	1986			
	Year	Year	Q1	Q2	Q3
<b>Fixed-rate bonds</b>					
Straights	96.6	146.0	49.1	28.4	22.5
Equity-related bonds	11.6	26.7	7.9	15.5	17.2
of which:					
Warrants	4.3	19.2	3.8	10.1	10.5
Convertibles	7.3	7.5	4.1	5.4	6.7
<b>Total</b>	<b>107.8</b>	<b>172.4</b>	<b>57.0</b>	<b>43.9</b>	<b>39.7</b>
<b>Floating-rate notes</b>	<b>55.9</b>	<b>47.8</b>	<b>2.7</b>	<b>1.7</b>	<b>2.5</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.

were issues by Japanese banks aiming to boost their capital bases. Japanese issues of bonds with equity warrants attached declined by 10%. New issues initially met with low levels of investor demand because coupons were felt to be too low and the Japanese stock market weakened. In addition, the losses made by Tateho Chemical Industries underlined investor concern that funds raised from warrant issues were being re-invested in financial markets in a way that could add to default risk. Following these events, significant increases in coupons—by up to 250 basis points—and a strengthening of the stock market helped the Japanese warrant bond market recover its buoyancy.

Aided by the strength of the domestic stock market, German borrowers increased significantly their use of equity-linked bonds, exclusively by means of bonds with warrants. Unlike Japanese issues, German warrant bonds tend to have a coupon in line with straight fixed-rate bonds. This means that, again unlike Japanese issues, German bonds from which the warrants have been stripped do not fall to a deep discount, and thus enjoy a more liquid secondary market.

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

\$ billions; percentages in italics

	Straight	Equity related
<b>Borrower:</b>		
Major OECD countries	13.2	16.8
of which:		
United States	4.4	1.4
Japan	1.8	12.5
Minor OECD	4.6	0.3
International institutions	4.3	—
Other	0.4	0.1
<b>Total</b>	<b>22.5</b>	<b>17.2</b>
<b>Currency:</b>		
US dollars	35.1	65.5
Swiss francs	19.4	19.3
Yen	5.8	—
Sterling	4.0	5.8
Australian dollars	8.0	0.8
Other	27.7	8.6

**Floating-rate notes**

FRNs would in normal circumstances be an attractive instrument when interest rates are expected to rise, but the difficulties experienced in the perpetual FRN market at the end of 1986 still cast a shadow over the market. Issuance remained weak in the three months to September, at \$2.5 billion. Issues in sterling, at

\$0.7 billion, exceeded those in dollars: £0.3 billion (\$0.5 billion) of sterling issues were backed by UK domestic mortgages. In addition to the \$2.5 billion in new issues there were \$1.4 billion of 'synthetic' or 'repackaged' FRNs, mainly created from previously issued ex-warrant bonds.

**Euronotes 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.*

Euronote facilities announced in the third quarter amounted to \$16.8 billion compared with a revised \$21.0 billion in the second quarter. This brought the total value of announcements for the first three quarters of the year to \$53.5 billion, compared with a revised \$70.7 billion for 1986 and \$50.3 billion for 1985. The value of facilities announced is not, of course, an accurate guide to the increase in notes outstanding because schemes may be only partially drawn down. However, estimates by Euro-clear suggest that the total value of outstanding euronotes has risen substantially in recent months, reaching \$53.8 billion by the end of September, compared with \$42.6 billion at the end of June.<sup>(1)</sup>

As has been the case since the beginning of 1987, almost 96% of all facilities announced were uncommitted. The relative proportions of eurocommercial paper (ECP), euro medium-term notes (EMTNs) and note issuance facilities (NIFs), issued on their own or as part of multiple-option facilities, were little changed from the previous quarter at 55%, 22%, and 23%, respectively. The proportion of facilities denominated in dollars fell from 91% in the second quarter to 77%, as more Japanese banks introduced euroyen certificate of deposit programmes. As a result, the yen's share increased to 10% compared with 2% in the second quarter. Borrowers in the euronote market have been mainly from developed countries, but recently some developing country issuers, such as Oman and India, have begun to use the market.

The medium-term note (EMTN) market continued to expand, with eight facilities totalling \$3.7 billion announced in the third quarter. Estimates by Euro-clear suggest that EMTNs outstanding at the end of September were \$1.9 billion compared with \$1 billion at the end of June. American issuers such as General Motors Acceptance Corp and Pepsico dominate the market at present.

Investors' growing interest in short-term paper is explicable by expectations of rising interest rates, together with the continuing illiquidity of the FRN market. Partly as a result of this investor interest, yields on ECP recently fell below those on domestic US commercial paper of similar maturities. There was thus a temporary cost advantage to issue of ECP even for issuers who have access to both markets. Dealers have been willing to take

(1) See 'Statistics on euronotes and eurocommercial paper' on pages 533-5.



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

\$ billions

	1985	1986	1987				
	Year	Year	Q3	Q4	Q1	Q2	Q3
Committed(b)	33.35	15.24	2.52	3.77	0.68	0.35	0.88
Uncommitted	16.95	55.00	14.81	14.57	15.01	20.66	15.93
<b>Total</b>	<b>50.29</b>	<b>70.74</b>	<b>17.33</b>	<b>18.34</b>	<b>15.69</b>	<b>21.00</b>	<b>16.81</b>
of which:							
Major OECD	29.49	44.06	11.71	10.90	9.60	15.52	9.69
Minor OECD	18.15	24.00	5.37	6.99	5.87	5.21	6.32
Other	2.65	2.68	0.25	0.45	0.22	0.27	0.80
<b>Selected nationalities of borrower</b>							
United States	16.52	18.46	5.19	5.06	2.39	7.62	4.43
United Kingdom	3.81	2.63	0.70	0.50	4.15	1.32	1.49
Australia	7.89	6.87	0.50	3.30	2.26	1.99	2.22
Japan	0.47	10.38	1.43	1.75	0.59	4.43	2.25

(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.

losses on their euronote operations in order to build market share and to provide a wide range of services to their customers. However, the intense competition for dealerships together with rising interest rates has led several of the dealing banks in the market to reduce the size of their positions or to withdraw from the market.

**Eurocurrency syndicated credits**

The recovery in syndicated credits observed in the first half of 1987 strengthened in the third quarter, when \$25.9 billion in new credits were announced. This brings the total value of credits announced so far this year to \$60 billion—twice the total announced in the whole of 1986. Indeed, syndicated loan announcements are returning to levels not seen for five years. The buoyancy of the market contrasts with the downward trend in activity observed in the fixed and floating-rate segments of the eurobond markets.

The recent recovery in syndicated lending has been attributed to a number of factors. First, the collapse of the FRN market blunted the attraction to investors of the principal alternative floating-rate instrument, while fixed-rate bonds proved unattractive for investors in an environment of rising interest rates. Second, the advantages of eurobonds for banks in terms of liquidity have reportedly not measured up to expectations. Third, the recent wave of merger and acquisition activity—particularly by UK companies in the United States—has been an important contributing factor this year. In the present context, syndicated credits have, for such purposes, the major advantage over securities issues that large sums of money can be raised in a relatively

**Announced eurocurrency syndicated credits**

\$ billions

	1985	1986	1987				
	Year	Year	Q3	Q4	Q1	Q2	Q3
Major OECD	5.06	11.61	2.02	5.36	9.55	8.58	22.32
Minor OECD	4.40	6.50	2.15	1.99	4.92	3.58	1.82
Developing countries	5.62	7.80	1.98	1.94	1.60	1.46	1.33
Eastern bloc	3.60	2.34	0.21	0.50	0.78	1.06	0.10
Other	0.28	1.52	0.21	0.38	0.82	1.78	0.30
<b>Total</b>	<b>18.96</b>	<b>29.76</b>	<b>6.57</b>	<b>10.18</b>	<b>17.67</b>	<b>16.47</b>	<b>25.87</b>
of which, transferable	5.77	3.34	0.10	0.44	0.38	0.78	0.47

short period. Fourth, the credits market has been subject to innovation in the form of syndicated multiple-option facilities, which have provided borrowers with a medium-term eurocurrency commitment, in the form of bank lending and multicurrency facilities, as well as allowing them access to a wide range of securitised instruments, such as euronotes and bankers acceptances. These newly evolved structures have narrowed the dividing line between loans and securities markets. Finally, there have been large one-off credits such as the £5 billion (\$8 billion) credit for the Eurotunnel consortium in the third quarter. Although some of these factors may be expected to be temporary, a durable growth in syndicated credits seems to be in prospect.

Continuing the pattern observed in recent quarters, the majority of borrowers in the syndicated loan market were from the major OECD countries (86%). New lending to developing countries and minor OECD countries continued to decline, accounting for only 6% and 7% respectively of new lending in the third quarter. Activity by Eastern Bloc borrowers was insignificant, accounting for less than 1%. Of the major OECD countries, UK borrowers were the largest fund raisers, with 57% of new loans (\$14.7 billion), followed by the United States with \$3.6 billion and Italy with \$1.7 billion. UK borrowers have raised \$23.7 billion so far this year, compared with \$9.5 billion for the United States and \$3.3 billion for Italy.

Most of the activity (86%) in the third quarter was by non-financial corporate borrowers—activity by sovereign borrowers was negligible—reflecting investment and merger activity of the corporate sector in the major OECD countries. Banks appear confident of the credit quality of corporate debt, despite the high levels of such debt outstanding in several countries. Syndicated lending terms have eased considerably because of intense competition.

The US dollar, the currency most often used in syndicated lending, saw its share decline from 82% in the second quarter to 44% in the third. The Eurotunnel and other sterling-denominated credits increased the share of sterling from 8% to 49%.

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

During the second quarter of 1987, total external lending by BIS-area banks rose by \$173 billion (5%). This represents a reversion to the rapid rates of growth seen in the second half of 1986, following a pause in the first quarter. As usual, most of the increased activity was attributable to interbank lending within the reporting area. This grew by \$147 billion (as opposed to \$47 billion in the first quarter), more than half of which was accounted for by banks in Japan and a further quarter by banks in the United States.

The proportion of new international lending denominated in dollars (by banks in the industrial reporting countries)



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

\$ billions; changes exclude estimated exchange rate effects

	1985	1986	1987				Out-standing at end-June 1987
	Year	Year	Q3	Q4	Q1	Q2	
<b>Liabilities vis-à-vis:</b>							
BIS-reporting area	176.9	383.5	128.9	162.4	63.8	146.3	2,377.8
'Offshore' centres	43.8	128.4	55.1	50.7	7.6	19.4	603.1
Sub-total	220.8	513.7	184.0	213.1	71.4	165.7	2,980.9
Outside-reporting area							
Developed countries	3.2	7.2	4.1	0.7	3.6	0.4	50.3
Eastern Europe	2.8	- 0.1	- 0.7	1.5	- 2.1	0.2	28.4
Oil exporters	7.6	- 21.9	- 2.7	- 5.0	1.4	7.4	154.9
Non-oil developing countries	5.7	12.8	5.1	6.8	4.5	14.6	217.7
of which, Latin America	0.4	- 0.6	- 1.3	1.5	- 0.7	5.7	76.2
Sub-total	19.3	- 2.0	5.8	4.0	7.4	22.6	451.3
Unallocated	2.5	29.9	11.1	8.6	16.3	- 1.7	161.9
<b>Total</b>	<b>242.5</b>	<b>541.6</b>	<b>201.0</b>	<b>225.8</b>	<b>95.1</b>	<b>186.6</b>	<b>3,594.1</b>
<b>Assets vis-à-vis:</b>							
BIS-reporting area	181.3	394.4	136.3	169.1	46.1	131.6	2,234.9
'Offshore' centres	24.3	96.2	38.7	34.4	15.4	32.2	567.1
Sub-total	205.5	490.6	175.0	203.5	61.5	163.8	2,802.0
Outside-reporting area							
Developed countries	6.8	6.6	0.7	3.9	1.1	1.3	120.7
Eastern Europe	5.7	3.4	0.6	0.5	- 0.7	1.3	75.4
Oil exporters	0.2	0.4	1.8	1.1	0.5	2.8	122.7
Non-oil developing countries	11.1	2.9	1.7	5.1	0.4	1.1	374.2
of which, Latin America	1.7	1.4	0.6	2.3	- 0.2	1.5	228.1
Sub-total	23.8	13.3	4.7	10.6	1.3	6.5	693.0
Unallocated	4.2	13.2	- 0.2	7.2	3.1	2.8	92.0
<b>Total</b>	<b>233.5</b>	<b>517.2</b>	<b>179.4</b>	<b>221.3</b>	<b>65.8</b>	<b>173.2</b>	<b>3,587.0</b>

rose from 18% in the first quarter to 79% in the second. The yen was the only other currency in which positions showed any growth at all. The largest fall was in euro Swiss franc claims; there was also a contraction in the ECU sector after two quarters of relatively strong growth.

Japanese banks' international business usually slows in the second quarter because of the unwinding of window-dressing operations undertaken prior to their financial year-end in March. But continuing competition among Japanese banks over balance sheet size meant that Japan showed the most rapid rate of growth of cross-border business among the individual reporting centres: its lending grew by 11% and deposits by 14%. Lending in foreign currencies by banks in Japan to the domestic non-bank sector rose by over 18%. As in 1986, therefore, banks in Japan became substantial net borrowers of foreign currency from abroad to fund this demand. Additionally, the external yen claims of banks in Japan rose by 11% as the Japanese banks channelled yen to overseas branches. This, in part, was to fund Japanese residents' demand for yen funds. The usual seasonal fall in Japanese banks' interbank business was reflected only in figures for domestic foreign currency interbank business.

In the United Kingdom, the unwinding of Japanese banks' window-dressing operations accounted for the contraction in domestic foreign currency interbank business. The interbank activity of other overseas banks in the United Kingdom made up most of the growth in the United Kingdom's cross-border claims. Banks in the United States (which in recent quarters have been takers of funds) became net exporters of domestic funds during

the second quarter. Banks in the United States were major providers of funds to the eurodollar market, where expectations about the continuing weakness of the dollar had driven up interest rates relative to those in the United States.

International lending to final users (excludes redepositing between the reporting banks) rose by \$70 billion, or 4%, during the second quarter, slightly more than in the previous three months. Most of this growth was within the reporting area, more than half being attributable to Japanese residents. The Japanese non-bank sector borrowed \$18.2 billion in foreign currencies from banks in Japan and a further \$7.2 billion in yen or foreign currency from banks overseas. Additionally \$7.3 billion of domestic yen lending was funded by banks' foreign currency borrowings. UK non-banks were again significant borrowers, obtaining \$8.4 billion in foreign currencies from UK banks and a further \$0.8 billion from banks abroad. Non-banks within the reporting area provided just under a third (\$22.6 billion) of all funds; non-banks in the United States provided around a quarter of this. Sizable deposits were also made by non-banks in the Benelux countries, and German non-banks continued to build up their eurodeutschmark deposits.

Lending to countries outside the BIS reporting area rose by \$6.6 billion, compared with a rise of only \$1.3 billion in the first quarter; this was in line with the usual seasonal trend. Recorded lending to non-OPEC developing countries rose by only \$1.1 billion but the figures understate actual new lending since they are affected by write-offs, debt/equity conversions and asset sales. For example, claims on Mexico rose by only \$1.7 billion despite its \$3.5 billion of drawings under the 1987 new money package. Claims on other Latin American countries fell, in particular those on Brazil which were down by \$1.0 billion. Asian borrowing showed a small decline but within this, China and Taiwan increased their borrowing while South Korea repaid some \$2.5 billion. Claims on Eastern Europe (largely the Soviet Union) rose by \$1.4 billion, while lending to developed countries outside the reporting area continued to expand only slowly, contrary to the usual seasonal pattern.

New deposits from outside the reporting area amounted to \$22.6 billion in the second quarter compared with \$7.4 billion during the first quarter. These financed nearly a third of banks' total final lending during the latest quarter, compared with 10% in the first quarter. Two thirds of the increase in these deposits came from non-OPEC developing countries, including \$4 billion from Mexico. Taiwan continued to increase its deposits; they have now risen by \$18 billion during the six months to end-June. OPEC countries' deposits (+ \$7.4 billion) showed their largest quarterly increase since 1980.

**The London market** (second and third quarters of 1987)  
During the second quarter of 1987, UK banks' external lending rose by \$23.6 billion (3%), almost double the



increase in the first quarter. On an annualised basis, growth over the first half of this year has slackened to around 10% from 14% in 1986.

In the second quarter, growth was as usual dominated by interbank business within the BIS reporting area. The smaller overseas bank groups, notably Canadian, Italian and French banks, provided much of the impetus behind this growth. Since mid-1985, banks in the United Kingdom have, on a net basis, been drawing increasingly on non-banks overseas for funding. Having been net users of funds amounting to \$15 billion at end-1985, non-banks are now net suppliers of \$22 billion.

In the second quarter, lending to Japan was particularly strong; net of deposits, Japan borrowed \$10.1 billion. Over the first half of 1987, Japan was a net taker of \$15.9 billion, compared with \$0.3 billion in the first half of last year, despite a slightly larger current account surplus. Non-Japanese banks in London appear to have taken a larger-than-usual share of lending to Japan during the second quarter. Although banks in Japan were the main borrowers, non-banks in Japan were also net takers.

Banks in the United States were net takers of \$0.9 billion (compared with \$6.5 billion in the first quarter). However, this was more than offset by gross placements by non-banks in the United States of \$8.8 billion, their largest-ever increase in deposits. Overall, the United States was a net provider of \$8.5 billion (the first time it has been a net provider since the second quarter of 1986). Germany (both banks and non-banks) was again a major depositor, as was, to a lesser extent, France.

Lending to countries outside the BIS reporting area barely grew in the second quarter, leaving net repayments for the half year. The only major groups to borrow were the oil exporters and Eastern Europe, with lending to the latter concentrated on the USSR, claims on which rose by 7%. The fall in lending to developed countries included a further fall in claims on Greece, which has made net repayments of \$0.9 billion since the beginning of 1986.

Outside-area countries' deposits increased by \$10 billion in the second quarter and these countries were significant net providers of funds to the London market. The increase in oil exporters' deposits reversed a trend that set in at the beginning of 1986. Among non-oil developing countries, Taiwan's deposits continued to grow strongly.

There was little business with the major debtors. However, Mexico's deposits rose by \$2.6 billion following the payment to Mexico of the first tranche (\$3.5 billion) of the commercial banks' 1986/87 new money package. There was little change in recorded claims on Mexico held by banks in the United Kingdom.

In the second quarter, dollar-denominated lending accounted for much of the increase in new lending,

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

\$ billions; changes exclude estimated exchange rate effects

	1985	1986	1987				Out-standing at end-June 1987
	Year	Year	Q3	Q4	Q1	Q2	
<b>Liabilities vis-à-vis:</b>							
BIS reporting area	39.2	67.4	36.9	12.2	14.5	28.9	544.8
'Offshore' banking centres	4.5	10.1	7.8	- 1.9	- 1.4	2.4	110.4
Sub-total	43.7	77.4	44.7	10.3	13.0	31.3	655.2
Outside reporting area							
Developed countries	1.2	0.2	1.4	- 1.0	0.8	1.8	17.4
Eastern Europe	1.2	—	- 0.1	0.9	- 1.1	0.1	7.3
Oil exporters	1.3	- 8.5	- 2.9	- 1.8	- 2.6	2.2	44.6
Non-oil developing countries	- 1.2	2.1	0.7	2.1	1.7	5.9	49.7
of which, Latin America	- 2.2	- 0.5	- 0.3	- 0.1	0.2	3.0	8.6
Sub-total	2.5	- 6.2	- 1.0	0.3	- 1.2	10.0	119.1
Unallocated	- 5.7	21.7	6.5	5.0	6.1	- 7.1	38.9
<b>Total</b>	<b>40.5</b>	<b>93.0</b>	<b>50.2</b>	<b>15.6</b>	<b>17.9</b>	<b>34.2</b>	<b>813.3</b>
<b>Assets(a) vis-à-vis:</b>							
BIS reporting area	29.0	69.0	36.8	13.5	12.1	20.4	511.2
'Offshore' banking centres	- 8.1	7.5	6.8	- 3.2	0.2	4.0	112.1
Sub-total	20.9	76.5	43.6	10.3	12.4	24.4	623.3
Outside reporting area							
Developed countries	2.2	1.0	- 0.2	1.3	- 0.5	- 0.1	36.4
Eastern Europe	3.3	2.4	0.4	0.6	- 0.4	0.6	19.8
Oil exporters	- 0.5	0.1	- 0.1	0.1	- 0.2	0.3	20.2
Non-oil developing countries	2.7	- 0.9	—	1.0	—	- 0.4	57.1
of which, Latin America	1.4	—	- 0.1	0.7	- 0.5	- 0.2	36.7
Sub-total	7.7	2.5	0.1	2.9	- 1.1	0.4	133.5
Unallocated	1.5	7.7	2.4	1.5	1.2	- 1.2	14.2
<b>Total</b>	<b>30.1</b>	<b>86.7</b>	<b>46.0</b>	<b>14.8</b>	<b>12.5</b>	<b>23.6</b>	<b>771.0</b>

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

perhaps reflecting the market's more favourable view of the dollar's prospects. Deutschmark, Swiss franc and sterling-denominated lending all declined. The yen accounted for nearly 20% of new lending, compared with 35% in the first quarter of 1987. Notwithstanding the recent strength of dollar-denominated lending, 62% of total outstanding lending was denominated in dollars at end-June 1987, compared with 76% at end-1984.

In the third quarter of 1987, international lending by all banks in the United Kingdom rose by 3%; almost all of this was to banks outside the United Kingdom. This brought the total rise in lending in the first nine months of 1987 to 9%, compared with 14% over the same period last year. UK banks' lending to the London interbank market rose slightly in the third quarter, and has risen by 12% over the first nine months of the year, compared with 8% over the same period in 1986. However, so far this year, UK banks' borrowing from the London interbank market has fallen by 1%. To a large extent this reflected reduced participation in the market by Japanese banks. UK banks' holdings of investments (which include FRNs) fell slightly for the third consecutive quarter, reflecting continuing uncertainties in the bond markets.

Japanese banks in London increased their international lending by 4% in the third quarter. In the nine months to end-September, their lending rose by 9% compared with 30% over the same period last year. The slowdown may reflect a shifting emphasis in Japanese banks' business away from volume of business towards return on assets.



This is being encouraged both by the Ministry of Finance in Tokyo and by the prospect of an international agreement on capital adequacy requirements. The slowdown has been most pronounced in the London interbank market where many Japanese banks have cut back their involvement because of fine margins. Although Japanese banks remained net providers of funds to own offices abroad over the first nine months of 1987, it was on a smaller scale than in 1986. Indeed in the third quarter of this year, Japanese banks were net takers of funds from own offices abroad; this is especially unusual in what has, traditionally, been a 'window-dressing' quarter.<sup>(1)</sup>

The expansion in US banks' business was the largest for over five years. The greater part of new lending was to both banks and non-banks in the United Kingdom.

## Foreign exchange and gold markets

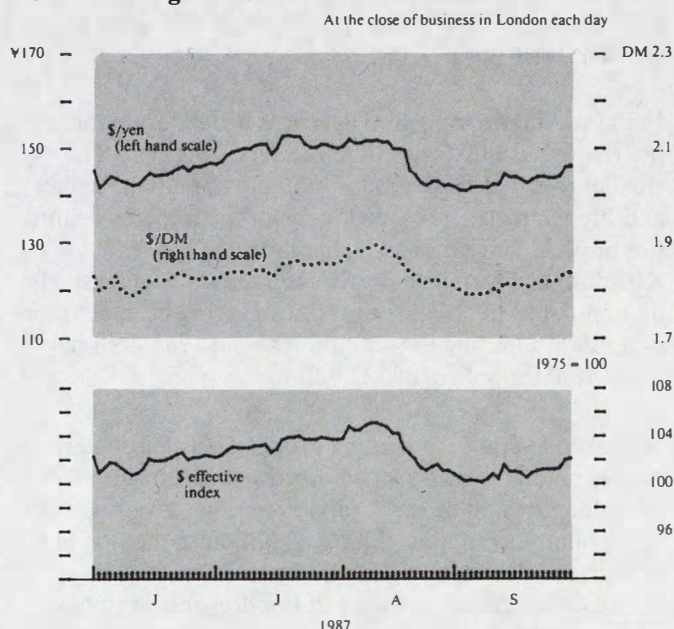
*This section reviews the three months to end-September*

### US dollar

The dollar enjoyed a period of strength throughout July and early August, interrupted only by a temporary fall in mid-July on the publication of worse-than-expected trade data for May, and, helped by rising tension in the Middle East, reached its highest levels since the Louvre accord. However, sentiment was reversed in mid-August by the release of a much larger than expected US trade deficit for June and, with July's figures also being worse than expected, the dollar fell rapidly despite a  $\frac{1}{2}$ % rise in the US discount rate. It rallied towards the end of the period as Finance Ministers of the Group of Seven (G7), meeting in Washington, reaffirmed their commitment to the Louvre accord and stable exchange rates.

The dollar opened in London on 1 July at DM1.8215 and ¥146.40. Better-than-expected wholesale trade sales data (+ 0.7%), a press report that the US Government regarded the dollar's rise as 'very satisfactory', and a speech by President Reagan which described the US trade deficit as falling, initially helped the dollar to rise to DM1.8530 and ¥151.55 on 13 July. Two days later, on the publication of an increased trade deficit for May of \$14.4 billion, it fell sharply, touching DM1.8269 and ¥148.30, but a bullish tone quickly re-emerged as higher oil prices depressed the yen and the deutschmark, and a high for the period of ¥153.20 was attained on 20 July. The dollar subsequently eased as oil prices fell and rumours circulated that the Federal Reserve were intervening, but, following the riots in Mecca in early August, it advanced strongly and, as concerns about the Middle East continued to develop, rose to its highest level against the deutschmark since the Louvre accord in February, reaching DM1.9030 in New York on 11 August. The dollar's rise was slowed by concerted central bank sales, but it took the release on 14 August of a larger-than-expected US trade deficit for June (\$15.7 billion) to change sentiment. The dollar subsequently fell sharply, with stop loss selling at times

### Dollar exchange rates



contributing to its decline. As Japan benefited from a further fall in oil prices, the yen led the advance on the dollar. Dollar sentiment deteriorated again towards the end of August in the wake of a record US current account deficit for the second quarter of \$39.5 billion. The publication, on 11 September, of a larger-than-expected US trade deficit for July of \$16.5 billion led to a further abrupt fall, and in hectic trading, the dollar dipped sharply to lows of DM1.7875 and ¥141.00. However, the dollar subsequently rallied in the wake of the communiqué on currency stability from G7 Ministers meeting in Washington, which reaffirmed their commitment to the Louvre accord, and advanced significantly towards the end of the period as Japanese institutional investors, optimistic about a possible reduction in the US budget and trade deficits, switched out of yen bonds and into dollars. The dollar closed September at ¥146.20, down  $\frac{1}{4}$ % on the quarter, and DM1.8390, up 1%; in effective terms, it fell by  $\frac{1}{4}$ % to 102.1.

### EMS

The EMS remained relatively comfortable throughout the period. July opened with the Danish krone at the highest position but it was almost immediately replaced by the French franc (which stayed at the top for the remainder of the period) as political uncertainties caused the krone to drift down the system. The krone reached the lowest position early in August and, with the exception of a short period at the end of that month (when the Belgian franc replaced it) remained there until the end of the quarter. The dollar's weakness in September caused some difficulties as the weaker EMS currencies failed to keep pace with the deutschmark and, as a result, there was some expectation that the mid-month meeting of European Community Finance Ministers might lead to a realignment. When this did not occur and the Italians announced a series of measures designed to stem

(1) An article on Japanese banks in London appears on pages 518-24.

speculation about the lira, the underlying tension subsided, the narrow band ending the period 1½% wide.

**Yen**

As it had done earlier in the year, the yen strengthened more rapidly than continental currencies against the weakening dollar during August. Following reported comments from Japanese ministers to the effect that the exchange rate should be left to the markets, the yen rose from ¥80.41(= DM1) at end-June to ¥78.20 on 24 August. It subsequently remained fairly stable at around ¥79, easing slightly on the publication of a reduced Japanese trade surplus, to close the period at ¥79.50.

**Gold**

Gold opened the period at \$449.50 and, influenced by developments in the Gulf, rose steadily throughout the latter part of July and early August despite the strong dollar. The increasing likelihood of a strike by South African miners helped it reach a high of \$476.00 on 4 August before easing in mid-month on reports that the Lebanon proposed selling 20% of its gold reserves. The effect of the settlement of the strike in South Africa at the end of August was neutralised by a renewed heightening of tension in the Gulf and, for the remainder of the period, gold traded quietly in a narrow range, closing the quarter with a final fixing of \$459.50.