International financial developments

Among the main developments:

- *There has been some evidence of further progress in reducing the large external imbalances of the major countries. Although the US current account deficit widened further in the first quarter, reflecting swings in the volatile invisibles component, there was a marked reduction in the trade deficit. Japanese monthly trade data have also shown a sustained reduction in the trade surplus since the beginning of the year.*
- *Activity in the international capital markets in the second quarter continued the strong recovery seen in the first, supported by the buoyancy of output in the major countries and a revival of confidence after the stock market slump in October last year.*
- *In the foreign exchange markets in the second quarter, the dollar was strongly influenced by the evolving pattern of US trade figures, weakening at first following publication of an increased deficit (for February) but recovering strongly thereafter as data for the two succeeding months showed marked improvement. Over the quarter as a whole the dollar rose by 6% in effective terms.*

Balance of payments positions

Current accounts

The data in this section are seasonally adjusted unless otherwise stated

Despite the fact that both the US current account deficit and the Japanese surplus widened in dollar terms in the first quarter of 1988 compared with the previous three months, there are signs of progress in reducing the large external imbalances of the major countries. The German surplus fell over the same period; the monthly Japanese current account surplus has shown a sustained narrowing since the beginning of the year; and the US trade deficit has fallen steadily from a peak in October, with exports particularly buoyant.

At the present time it is difficult to draw firm conclusions, partly because current account data have been affected by a number of special factors recently. In the United States, recorded net invisibles transactions have been volatile, and in Europe the introduction of the single administrative document has clouded trade data.

The US current account deficit widened to $40 billion in the first quarter of this year, from $34 billion in the final three months of 1987. This was despite a marked improvement in the visible deficit, which narrowed to $36 billion from $41 billion over the same period. This decline largely reflected a sharp rise in export volumes (up 27% on a year earlier) as well as the waning influence of short-run terms of trade losses from dollar depreciation in 1987. The latest monthly figures seem to confirm a downward trend in the US visible trade deficit. The increase in the invisibles deficit in the first quarter of 1988 was due partly to a return to more normal levels of recorded earnings on US direct investment abroad, which had been artificially boosted in the fourth quarter of 1987 by gains from revaluations of foreign assets.

World current accounts[a]

$ billions; *seasonally adjusted*

	1985	1986	1987					1988
	Year	Year	Year	Q1	Q2	Q3	Q4	Q1
OECD economies:								
United States	-118	-141	-154	-38	-40	-42	-34	-40
Japan	49	86	87	25	21	20	20	23
Germany	17	39	45	12	11	11	10	9
France	—	3	- 5	—	- 1	- 1	- 3	1
United Kingdom	4	—	- 3	1	—	- 1	- 2	- 5
Italy	- 4	3	- 1	- 2	1	2	- 1	..
Canada	- 1	- 8	- 8	- 1	- 1	- 2	- 3	- 1
Major economies	- 53	- 17	- 38	- 4	- 9	-14	-12	..
Other OECD	- 4	- 3	- 6	- 1	- 1	- 1	- 3	..
Total OECD	- 57	- 20	- 44	- 5	-10	-15	-15	..
OPEC economies	6	- 31	- 11	- 5	- 3	- 1	- 1	..
Non-OPEC developing economies	- 24	- 13	10	—	3	4	3	..
Other economies(b)	3	2	5	1	1	1	1	..
World discrepancy(c)	- 71	- 62	- 39	- 8	- 8	-11	-12	..

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

(b) The centrally planned economies.

(c) Equals the overall identified balance. The negative sign implies that errors arising from incomplete coverage, timing differences and other statistical deficiences are resulting in the omission of positive influences (eg unrecorded services and investment income).

The Japanese current account surplus increased to $23 billion in the first three months of 1988. However, this figure masks some favourable developments. The widening of the current account surplus occurred at the turn of the year, with some subsequent narrowing in February and March, albeit at a slow rate. This progress continued in April and May, and the current account balance in the three months to May was a surplus of $19 billion.

In some European economies the current account position has weakened. In Italy, the strong rise in domestic demand and a deterioration in the terms of trade reduced the current account from surplus to slight deficit at the end of last year. The UK current account deficit widened to $5 billion in the first quarter from $2 billion in the previous three months, reflecting rapidly increasing import volumes. The German current account surplus declined from $10 billion in the fourth quarter of 1987 to $9 billion in the first quarter of this year. Stronger-than-expected domestic demand growth and the cumulative loss in competitiveness have contributed to this decline. France's external performance, by contrast, has been stronger than expected. According to provisional data, the current account was in surplus by about $1 billion in the first quarter of this year, compared with a deficit of $3 billion in the previous three months. Over the first half of 1988, the trade account was in deficit by around $1.6 billion, compared with deficits of $3 billion in the first half of 1987 and $2 billion in the second.

Elsewhere, there seems to have been an improvement in the current account position of non-OPEC developing economies, helped by, *inter alia*, strengthening commodity prices. Mexico and Brazil have shown improvement on the basis of the evidence available so far in the first quarter. Among the Asian newly industrialising economies, South Korea had a $3 billion surplus (not seasonally adjusted) in the first quarter, up from $2 billion in the first three months of 1987. Taiwan's surplus dropped significantly, to $1.3 billion (not seasonally adjusted) from $4.6 billion a year earlier. However, this reflected substantial gold purchases from the United States, which helped raise imports to $11.5 billion in the first quarter of 1988, up from $6.5 billion a year earlier.

Oil exporting countries continued to run a current account deficit ($2.9 billion) in the first quarter, bringing the total for the last four quarters to $8.3 billion. There was a modest withdrawal of investment funds (net) from the United Kingdom, bank deposits being reduced by more than the continued investment in securities (including the purchase of further shares in BP by the Kuwait Investment Office). Withdrawal from elsewhere in Europe and the United States was more marked. The level of identified deployed assets of $458.4 billion at end-March (some $15 billion below the current estimate for the previous quarter) reflects the fall, in US dollar terms, of the value of assets denominated in other currencies.

Capital accounts

On the limited evidence so far available, it would appear that official sector financing of the US current account deficit has declined since the early weeks of 1988, when there was substantial intervention to support the dollar. Net quarterly flows of portfolio investment in the United States from private sources fell from an inflow of $15 billion per quarter in the first half of the year to an outflow of $5 billion in the fourth quarter. This was partly reversed to an inflow of $9 billion in the first quarter, as confidence was re-established. There was, nevertheless, a substantial continuing net inflow from official sources in the first quarter as a whole. This included a $28 billion inflow of purchases of Treasury and other US securities by foreign official authorities and a $2 billion fall in US official reserves. This flow was thought to be heavily concentrated in the early part of the quarter. Evidence from recent Treasury auctions and capital markets activity suggests that the confidence of the private sector in dollar assets has continued to improve as the year has proceeded. Direct investment into the United States has risen, resuming the trend of recent quarters, following an outflow in the fourth quarter. The latter reflected the bookkeeping counterpart to the revaluation of overseas assets, which was treated as investment income in the current account.

Although there was a net capital outflow of about $15 billion from Japan in the first quarter—about the quarterly average for the 1987/88 fiscal year as a whole—there was a sharp fall in the net outflow through securities transactions, reflecting both a fall in Japanese investment abroad and a recovery in foreign investment in Japanese securities. Foreigners were net purchasers of Japanese stocks for the first time since the first quarter of 1986. The fall in net portfolio investment abroad was

Identified deployment of oil exporters' funds[a]

$ billions

	Mar. 1987 levels	1987 Q2	Q3	Q4	1988 Q1	Mar. 1988 levels
Industrial countries						
United Kingdom:						
Sterling bank deposits	6.9	-0.1	0.4	2.0	—	10.5
Eurocurrency bank deposits	35.6	2.3	-0.4	-0.9	-1.1	36.0
Government paper	5.9	-0.4	1.1	-0.7	0.3	7.3
Other investments	9.9	0.1	0.2	1.6	0.6	13.1
	58.3	1.9	1.3	2.0	-0.2	66.9
Other EEC:(b)						
Domestic currency bank deposits	6.3	0.2	0.2	-0.4	0.6	7.5
Eurocurrency bank deposits	18.9	1.4	-0.2	1.7	-0.2	22.0
Other investments	70.9	0.7	-0.2	-1.9	-3.1	56.4
	96.1	2.3	-0.2	-0.6	-2.7	85.9
United States:						
Bank deposits	20.0	0.7	2.5	-0.7	-0.6	21.3
Government paper	22.2	-0.8	0.3	-1.7	-0.4	19.6
Other investments	24.7	-0.8	-1.3	—	-1.1	21.5
	66.9	-0.9	1.5	-2.4	-2.1	62.4
Other:						
Domestic currency bank deposits	5.0	-1.4	-0.3	2.2	-0.5	6.0
Eurocurrency bank deposits	27.4	1.3	0.7	2.0	1.4	32.9
Other investments	48.3	-1.7	-7.5	5.1	-0.4	43.4
	80.7	-1.8	-7.1	9.3	0.5	82.3
Offshore centres:						
Bank deposits	43.4	2.7	-1.0	1.9	1.2	48.2
Placements with ldcs	59.5	—	—	—	—	59.5
OEC credit to non-banks	12.4	0.3	—	—	0.1	12.8
IMF and IBRD(c)	39.2	-0.8	-0.2	-0.2	0.2	40.4
Total identified additions(+)/reductions (-) in deployed assets	**456.5**	**3.7**	**-5.7**	**10.0**	**-3.0**	**458.4**
Net funds available for deployment		-1.4	-2.7	-1.4	-2.5	
of which:						
Net movements in external borrowing etc		*1.3*	*-1.4*	—	*0.4*	
Current balance		*-2.7*	*-1.3*	*-1.4*	*-2.9*	

(a) The oil exporting countries covered are defined in the notes and definitions to Table 16 of the statistical annex in the February 1988 *Bulletin*.

(b) Includes Spain and Portugal.

(c) Includes holdings of gold.

External financing of the G7 countries, 1985–88 Q1

$ billions, *not seasonally adjusted*
(Inflow+/Outflow−)

	1985	1986	1987 Year	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 Q1
Identified current account								
United States(a)	−118	−141	−154	−38	−40	−42	−34	−40
Japan	49	86	87	21	23	21	22	19
Germany	17	39	45	11	11	8	15	9
France	—	3	− 5	− 2	—	− 1	− 2	..
United Kingdom	4	—	− 3	1	− 1	− 2	− 1	− 6
Italy	− 4	3	− 1	− 2	1	2	− 2	..
Canada	− 1	− 8	− 8	− 3	− 2	− 1	− 3	− 4
Financed by:								
Portfolio investment								
United States(a)	63	109	75	26	25	11	14	32
Assets	− 8	− 3	− 5	− 2	—	− 1	− 2	− 4
Liabilities	71	112	80	28	25	12	15	37
of which:								
From official sector	*− 1*	*33*	*45*	*12*	*11*	*2*	*20*	*28*
From private sector	*71*	*79*	*35*	*16*	*14*	*10*	*− 5*	*9*
Japan	− 43	−105	− 97	−25	−39	−10	−23	− 6
Germany	2	24	5	10	4	− 5	− 5	− 9
France	6	2	5	1	1	1	2	..
United Kingdom	− 14	− 22	33	2	4	7	20	− 4
Italy	—	− 2	..	—	—	—	..	..
Canada	8	16	10	4	3	4	− 1	2
Direct investment								
United States(a)	− 1	− 3	− 2	− 3	1	7	− 8	5
Japan	− 6	− 14	− 18	− 3	− 4	− 5	− 6	− 8
Germany	− 4	− 8	− 7	− 1	− 2	− 1	− 3	− 2
France	—	− 3	− 4	—	− 1	− 1	− 2	..
United Kingdom	− 6	− 11	− 16	− 2	− 8	− 6	− 1	− 2
Italy	− 1	− 3	..	—	− 2	− 3	..	..
Canada	− 6	− 2	− 1	1	− 1	—	− 1	—
Banking sector								
United States(a)	40	19	51	19	− 4	30	6	− 1
Japan	—	49	56	18	25	−11	24	− 8
Germany	− 9	− 23	− 4	− 4	− 6	4	3	7
France	− 1	4	− 10	− 1	− 3	− 1	− 6	..
United Kingdom	10	15	5	6	9	− 6	− 5	5
Italy	− 3	3	4	3	1	− 2	2	..
Canada	—	− 4	2	—	—	1	1	1
Other(b)								
United States(a)	20	16	21	− 7	16	− 5	18	2
Japan	− 1	—	12	6	7	8	− 8	7
Germany	− 6	− 31	− 20	− 8	− 3	− 6	− 3	− 7
France	− 3	− 5	14	2	1	3	9	..
United Kingdom	8	22	2	− 5	3	7	− 4	8
Italy	− 1	− 5	2	4	− 4	− 1	4	..
Canada	− 1	− 2	1	2	− 1	− 3	4	5
Official financing balance (− = increase in reserves)								
United States(a)	− 4	—	9	2	3	—	4	2
Japan	—	− 16	− 39	−16	−11	− 3	− 9	− 3
Germany	—	− 1	− 18	− 8	− 3	1	− 8	2
France	− 3	− 1	—	− 1	2	− 1	1	..
United Kingdom	− 2	− 4	− 20	− 2	− 7	—	−10	− 1
Italy	7	− 1	− 5	− 4	2	2	− 5	..
Canada	—	—	− 3	− 4	2	− 1	—	− 4

(a) Seasonally adjusted.
(b) Includes balancing item which reflects unidentified net flows which may be either current or capital flows.

offset by a decline in net banking flows, which became a substantial net outflow. In April and May, Japanese investment in foreign bonds showed a marked recovery, associated with the rise in the dollar, while foreigners resumed net sales of Japanese securities.

Preliminary first quarter data suggest that Germany's capital outflow was of much the same magnitude as that seen in the second half of last year. The outflow of funds on portfolio account continued to rise and was about $9 billion in the first quarter. The turnaround in net portfolio investment, estimated at $20 billion in the year to the first quarter, was accompanied by a rise in yields on German bonds relative to those abroad during that period. The rise in net outward portfolio investment in recent quarters mainly reflects an unusually large increase in German investment in foreign bonds and a reduction in investment by foreigners in German bonds, both of which may partly be in anticipation of the withholding tax to be levied on interest payments, due to be introduced in 1989. In addition, foreigners have been reducing their holdings of German equities following last October's share market falls. In the fourth quarter of 1987, there were modest net capital inflows into France and Italy. Net inflows into Italy followed the implementation of a firmer monetary policy in late summer.

The effects of the stock market crash were evident in the Canadian capital account at the end of 1987. There was a reversal of portfolio investment flows, from an inflow averaging about $4 billion in the first three quarters of the year to an outflow of $1 billion in the last quarter. This reversal was financed by net banking inflows, which responded to a tightening in Canadian monetary conditions in the last quarter of the year.

There was a sharp reversal in UK net portfolio investment, to an outflow of $4 billion, in the first quarter, following substantial net inflows in the last quarter of 1987. In that quarter, domestic institutions switched funds to the domestic market from abroad in the aftermath of the stock market collapse. Some foreign companies with sizable liquidity also took the opportunity to purchase stocks in UK firms.

International capital markets

Overall activity in the international capital markets in the second quarter continued the strong recovery seen in the first, despite a substantial fall in the announcement of euronote facilities. Issuance of equity-linked bonds by Japanese entities, particularly industrial companies, rose sharply and there was a doubling in the issuance of floating-rate notes. The volume of straight fixed-rate bonds fell back below first quarter levels, although issues in some of the minor currencies developed strongly. The announcement of syndicated credits, although slightly lower than in the first quarter, nevertheless maintained the high level of activity which has been observed since the beginning of 1987. Capital market activity was supported by strong or improving economic activity in the major OECD countries, the continuing worldwide wave of corporate restructurings, a revival of issuer and investor confidence after the October 1987 stock market slump, the desire of issuers to lock into relatively cheap funds in anticipation of higher interest rates and an improvement in sentiment towards the dollar following better US trade figures. Activity in debt markets was also stimulated by the continuing high cost of equity finance in the wake of the fall in equity prices last October.

Fixed-rate bonds

The volume of fixed-rate bonds issued was over $56 billion, about the same level as in the first quarter. A decline in straight (ie non-equity-related) fixed-rate bonds was offset by a near-doubling in the volume of

Outstanding debt and net credit flows in the international bond markets

In its latest Annual Report, the BIS published data on international bonds (euro and foreign bonds) outstanding and on net flows through the international bond markets. The series represent the first attempt to aggregate the stocks of outstanding international bonds within a consistent framework.[1] These new data have been derived mainly from Bank of England and OECD sources and from information published by the Association of International Bond Dealers on bonds outstanding, and scheduled and early repayments. Stocks have been estimated for 1982, 1985, 1986 and 1987. The data include fixed-rate issues (straight and equity-related) as well as floating-rate notes. Aggregate figures in the various currencies have been converted into US dollars and the 'valuation effects' of changes in the values of the various currencies have been taken into account in the compilation of the tables. The bond repayment figures, in addition to gross flows at issue, will allow analysts of financial markets to obtain a better understanding of international credit flows through such instruments. The BIS intends to make this new information a regular feature of its quarterly release.

The share of dollar-denominated bonds in end-year stocks has declined from 57% at the end of 1985 to 43% at end-1987. The sharp decline since 1985 largely reflects the fall in the value of the US currency against the other main issuing currencies, and the consequent drop in the issuance of dollar paper (as international investors became reluctant to hold US dollar assets). The fall in dollar-denominated issuance also resulted in a slowdown in the pace of overall primary market activity from almost $219 billion in 1986 to a little over $180 billion last year. In addition, primary market activity in fixed-rate international bonds was also affected by rising interest rates for much of 1987. Particular weakness was evident in the eurodollar floating-rate sector following the collapse of the market at the end of 1986. Issuance has however been sustained since 1985 by a marked increase in equity-related issues, which are mainly denominated in US dollars. By contrast, there has been a substantial increase in the share of yen paper since 1985 from 8% to 12%, while several second-tier currencies such as sterling and the ECU have consolidated their positions. Although, the ECU only represents 4% of total outstanding issues, it has been one of the fastest growing sectors of the market.

By type of instrument, straight fixed-rate bonds accounted for 72% at end-1987, as against 82% in 1982, while equity-related issues have increased in share over the same period from 7% to 12%. By category of issuer (not shown in the table), the share of debt accounted for by financial institutions has expanded markedly since 1982 from 22% to 31%, while private non-financial entities' debt has remained steady at 38%. The share of governments and their agencies and international institutions has fallen from about 39% to 31%. By nationality of debtor, borrowers from industrial countries have become more prominent, with their share of the total rising from 73% to 82%, while the share of developing countries fell from 7% to 3%. Outstanding bonds from Eastern bloc countries have remained of marginal importance throughout the period. One salient feature has been the very rapid growth in international bonded debt issued by Japanese borrowers, who seem likely to overtake US issuers as the largest debtors in the international bond market, with almost $151 billion in outstanding bonds at end-1987 compared with $163 billion for US issuers.

Despite a slowdown in the pace of gross new issues in 1987 there was a marked increase in outstanding debt of $209 billion, a 27% rise over the previous year. However, $100 billion of that growth was due to valuation effects arising out of the appreciation of other currencies relative to the dollar; the balance reflected changes in volume. Excluding exchange rate effects, the increase in the volume of net new borrowing (almost $109 billion) in 1987 was, however, much smaller than in 1986 (nearly $157 billion), partly because of the reduced volume of new gross issues, but also because of an increase in the retirement of bonds from $62 billion to almost $72 billion.

Debt outstanding and net borrowing in the international bond markets, by type and currency of issue

$ billions

	Stocks		Changes in 1986			Stocks at end-1986	Changes in 1987			Stocks at end-1987
	End-1982	End-1985	Gross new issues(a)	Repayments(b)	Exchange rate effects		Gross new issues(a)	Repayments(b)	Exchange rate effects	
Total issues	**255.0**	**557.4**	**218.8**	**−62.1**	**58.5**	**772.6**	**180.6**	**−71.9**	**100.0**	**981.3**
Type of issue:										
Fixed-rate bonds	225.0	436.6	170.1	−40.7	56.3	622.3	168.7	−59.8	93.2	824.4
of which, equity-related	*17.0*	*44.0*	*26.1*	*− 3.5*	*5.2*	*71.8*	*44.7*	*− 7.2*	*10.2*	*119.5*
Floating-rate notes	30.0	120.8	48.7	−21.4	2.2	150.3	11.9	−12.1	6.8	156.9
By currency of issue:										
US dollars	144.0	315.8	119.7	−41.7	—	393.8	66.2	−36.2	—	423.8
Yen	16.5	42.7	22.3	− 2.3	12.3	75.0	26.0	− 4.6	25.3	119.0
Swiss francs	43.0	78.9	23.3	− 7.7	23.0	117.5	23.7	−16.1	31.9	157.0
Deutschemarks	31.0	50.4	16.5	− 5.1	14.6	76.4	13.7	− 9.0	17.4	98.5
Sterling	4.0	19.2	11.1	− 0.6	0.3	30.0	15.1	− 1.1	10.2	54.2
Australian dollars	0.1	3.4	3.4	—	− 0.2	6.6	9.0	—	0.9	16.5
ECU(c)	2.0	16.5	6.1	− 1.9	3.8	24.5	8.2	− 0.8	6.4	38.3
Other	14.4	30.5	16.4	− 2.8	4.7	48.8	18.7	− 4.1	7.9	71.3

Source: Bank for International Settlements, Annual Report 1 April 1987–31 March 1988, pages 129–32. The table above is an aggregated version of one of the tables in the BIS Annual Report.

(a) Figures based on completion dates, which may differ from those based on announcement dates given in other tables. Converted at current exchange rates.

(b) Scheduled (including sinking funds) and early repayments of issues (−), plus implied interest accruals on zero coupon bonds (+). Non-dollar figures are converted into dollars at the exchange rate prevailing at the beginning of the period.

(c) Excludes bonds issued in borrowers' national markets.

(1) A few international securities firms have occasionally produced analyses of stocks of international bonds but the information was less detailed than the BIS data.

Announced international bond issues[a]
$ billions

	1986	1987			1988	
	Year	Year	Q3	Q4	Q1	Q2
Fixed-rate bonds						
Straights	144.4	116.9	22.0	19.8	48.7	41.0
Equity-related bonds	27.5	43.3	17.2	2.6	7.9	14.9
of which:						
Warrants	*19.7*	*25.6*	*10.2*	*1.1*	*5.5*	*10.8*
Convertibles	*7.8*	*17.7*	*6.7*	*1.4*	*2.4*	*4.1*
Bonds with non-equity warrants (currency, gold, debt)	3.7	3.4	0.5	0.3	0.2	0.7
Total	**175.6**	**163.6**	**39.7**	**22.7**	**56.8**	**56.6**
Repayments	−39.5	−59.6	−17.9	−18.3	−18.7	−15.3
Floating-rate notes	**47.8**	**12.0**	**2.5**	**5.0**	**3.1**	**6.0**
Repayments	−20.0	−12.5	− 3.1	− 2.7	− 3.1	− 3.5

(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. Figures may not add to totals because of rounding.

equity-linked issues. Not only has gross bond issuance recovered substantially since the last quarter of 1987, but *net* volumes of bonds floated so far this year have also been higher on average than in 1986 and 1987. The increase in the volume of new issues since the beginning of the year is likely to have helped underwriters to regain profitability, which is one reason why the retrenchment observed in 1987 in the euromarkets has moderated somewhat. Several banks and securities firms have nevertheless contracted the range of their market-making operations and have changed the emphasis of their activities.

The volume of straight fixed-rate issues fell from $48.7 billion to $41.0 billion, but nevertheless remained $12 billion above the quarterly average for 1987. The prospects of higher financing costs encouraged a number of issuers to lock in borrowing costs at levels prevailing in the second quarter. Many issuers continued to respond to investors' fears of illiquidity by bringing large-size issues to market. In the second quarter, the average size of eurobond issues was $107 million (in dollar equivalent terms), which was large by historical standards.

There were reports of mispricing of issues early in the quarter, but underwriters generally responded to investors' caution by ensuring that primary market pricing was in line with levels prevalent in the secondary markets. Borrowers were nevertheless able to obtain funds at very competitive costs through the arrangement of increasingly sophisticated swaps. This appears to confirm a shift in the locus of innovation away from complex securitised instruments and towards the arrangement of swap transactions.

The volume of issues denominated in the US dollar, at $10.4 billion, maintained the high pace of announcements witnessed since the beginning of the year. Initial uncertainty about the US currency did, however, produce a further shortening of the maturities offered by some issuers, with a few issues having a maturity as short as one year. These issues were targeted at specific types of investors as they were reported to offer neither the liquidity of US Treasury bills nor the yield available on bank deposits. The volume of issues denominated in the deutschemark and the Swiss franc halved. Investment in deutschemark-bloc instruments was adversely affected by the low yields on these assets, which were not matched by anticipations of currency appreciation relative to the dollar or the yen.

Currency composition of fixed-rate bond issues
Percentages of total issues

	Straight bonds			Equity-related bonds		
	1987	1988		1987	1988	
Currency denomination	Year	Q1	Q2	Year	Q1	Q2
US dollars	25	23	25	67	67	72
Swiss francs	14	16	9	17	25	10
Yen	19	12	16	—	—	—
Deutschemarks	10	15	10	5	2	1
Sterling	8	11	9	9	6	9
Australian dollars	7	3	6	1	—	2
Canadian dollars	5	8	10	—	—	—
Other	12	12	15	1	—	6

Following the reaffirmation of the international agreement to promote currency stability in December 1987, investors seem to have switched their attention to high-yielding bonds such as those denominated in ECUs, Canadian dollars and Australian dollars. The high coupons proved particularly attractive to continental European investors. The Australian dollar sector benefited from the appreciation of the currency and high nominal interest rates: issuance in Australian dollars almost doubled to $2.6 billion. Issuance in the Canadian dollar ($4.1 billion) was helped by an appreciation relative to the US dollar and attractive swap opportunities. The ECU also benefited from frequent swap windows, with issuance rising to $3.0 billion. The ECU and Canadian dollar sectors both saw their largest ever issues during the quarter, reflecting a broadening of the investor base for bonds denominated in these currencies and a maturing of these minor currencies' markets.

Borrowing by US institutions rose from $2.8 billion in the first quarter to $4.9 billion in the second as US corporate issuers returned to the euromarkets. The dollar's weakness in earlier quarters had made the domestic market cheaper for these issuers, especially for longer maturities. In the second quarter, the resurgence of activity reflected the greater strength of the domestic economy and increased investor confidence in the US dollar. Japanese borrowing rose from $2.1 billion to $3.3 billion (8% of the total). Of total financing in the straight eurobond market, non-financial corporations increased their volume of issuance from $22.6 billion to $28 billion, governments

Activity in the eurobond markets, by sector
$ billions

	Fixed-rate bonds			Floating-rate notes		
	1987	1988		1987	1988	
	Year(a)	Q1	Q2	Year(a)	Q1	Q2
Industrial sector	18.2	22.6	28.1	0.6	0.1	0.1
Financial sector	12.3	17.7	17.5	1.8	2.6	5.4
of which, banks	*8.6*	*12.3*	*11.4*	*0.7*	*0.6*	*1.5*
Government sector	5.9	10.1	6.2	0.5	0.3	0.4
International institutions	4.6	6.4	4.7	0.2	0.1	—
Total	**41.0**	**56.8**	**56.6**	**3.1**	**3.1**	**6.0**

(a) At quarterly rates.

and international institutions reduced theirs from $16.5 billion to $10.9 billion, while financial sector institutions maintained their borrowing at similar levels to the first quarter.

Equity-related issues

New issues of equity-related fixed-rate bonds rose from around $8 billion in the first quarter to almost $15 billion in the second, approaching the high levels witnessed before the October stock market crash. Of this total, about 70% comprised bond issues with attached equity warrants, most of which were issued by Japanese entities. The attraction of these issues for investors was enhanced by the rise of the Japanese stock market to record levels during the quarter, and many of the bonds began trading at a healthy premium to issue price. This strong performance was reported to have constituted a significant source of profits for the underwriters.

All of the Japanese borrowing through bonds with equity warrants was accounted for by industrial companies. A large part of the yen funding, which is obtained from these issues by way of currency swaps, is likely to be earmarked for productive as opposed to financial investment, as growth in the industrial sector is proceeding at a brisk pace and prospects for the domestic economy have improved sharply. Support for this view has been found in surveys which suggest that the amount of speculative financial operations (zaitech) by Japanese non-financial companies has declined in 1988. The dollar remained the dominant currency of denomination for these issues. Coupons edged up in May, reflecting a desire to bolster the market ahead of an expected heavy flow of issues in June and July which led to concerns among some market participants that the strength of issuance could cause an oversupply of paper in the market. Several issuers took advantage of the recent reduction by the Japanese Ministry of Finance in the minimum permitted maturity of these instruments from five to four years.

The issuance of bonds convertible into equity rose from $2.5 billion to $4.1 billion. Borrowing in this form by Japanese entities, which halved to $1 billion, was entirely accounted for by industrial companies. Borrowers from France and the United States returned to the market after an absence in the first quarter, while convertibles from UK and Australian borrowers doubled. Many of the convertible bonds included put options, which allow holders to sell the bonds back to the issuer prior to maturity at a fixed price. Sterling convertible issues with put options were particularly popular as the yield to put was at an attractive premium to gilt yields.

Floating-rate notes

The volume of announcements of floating-rate note (FRN) issues rose from $3.1 billion in the first quarter to $6.0 billion in the second, but remained well below the $12 billion quarterly average that was seen during the peak of the market in 1985–86. The stronger activity in the primary market during the quarter was enhanced by expectations of higher interest rates in the major issuing currencies. New issues were also encouraged by an increase in demand in the secondary market, with sovereign issues being particularly favoured.

Issuers located in the United Kingdom continued to be the most active borrowers, accounting for a little over half of all FRN issues. The bulk of this represented issues which were related to mortgage finance. This included £750 million ($1.4 billion) of sterling-denominated mortgage-backed bonds used to securitise domestic mortgages by way of off-balance-sheet vehicles, and $1.8 billion worth of issues, several of which were subordinated, from UK building societies. There was also increased activity by borrowers from France and the United States. The market for asset-backed instruments continued to develop during the quarter with an increase in the average size of individual issues as the investor base for this type of instruments broadened.

The Commonwealth Bank of Australia was the first institution to introduce a public issue in the perpetual FRN sector since the market collapse of late 1986. The $300 million issue of 'undated' exchangeable notes provided the attraction of a government guarantee and an option to convert the notes into senior-ranked five-year FRNs after five years. Meanwhile, a £200 million issue by Lloyds Bank of variable-rate notes will allow the coupon to be reset every three months at a rate agreed between the bank and the lead managers.

Euronotes and other facilities

During the second quarter there was a significant decline in announcements of new euronote programmes, with activity falling to $14.3 billion compared with $23.4 billion in the first quarter. As in the first quarter, eurocommercial paper (ECP) and eurocertificates of deposit accounted for the majority of new announcements (66%). The main reason for the decline in new announcements appears to have been that many sovereign and corporate borrowers have already acquired such programmes. Future growth in the market can be expected as much from the greater intensity of use in existing

Announced euronote facilities[(a)]
$ billions

	1986	1987			1988	
	Year	Year	Q3	Q4	Q1	Q2
Committed(b)	15.2	3.6	1.0	1.6	1.0	0.8
Uncommitted	55.4	67.0	16.3	14.9	22.4	13.5
Total	**70.6**	**70.6**	**17.3**	**16.5**	**23.4**	**14.3**
of which:						
Major OECD	*44.6*	*46.1*	*10.0*	*11.0*	*14.4*	*6.4*
Minor OECD	*23.8*	*22.7*	*6.5*	*5.0*	*8.0*	*6.7*
Other	*2.2*	*1.8*	*0.8*	*0.5*	*1.0*	*1.2*
Selected nationalities of borrower						
United States	19.0	15.0	4.3	0.8	4.1	1.1
United Kingdom	2.6	9.5	1.5	2.5	4.1	2.2
Australia	6.4	8.0	2.5	1.2	1.7	1.4
Japan	10.4	10.0	2.3	2.6	—	1.8

(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.

programmes as from new announcements. The stock of euronotes outstanding, which is a more reliable indicator of the actual importance of these instruments in raising short-term funds, has increased from $52.7 billion at the beginning of the year to $66.5 billion at the end of June, an increase of $13.8 billion compared with just $5.8 billion in 1987 as a whole. These data suggest that use of existing facilities is increasing. Indeed, it is reported that the supply of funds from non-bank investors has expanded noticeably in recent quarters, and there has been an increasing issuance of hedged ECP which has attracted non-US dollar investors. Moreover, many borrowers who would previously have issued bonds backed by swaps are now moving into the short-term market through the issuance of ECP backed by multiple-option facilities.

A majority (86%) of new programmes announced were dollar-denominated, although a number of them incorporated options which allowed the borrower to issue notes in other currencies. Sterling remained the second most important currency. The value of programmes announced on behalf of major OECD countries fell sharply from $14.3 billion to $6.4 billion, an amount exceeded, for the first time since 1984, by announcements on behalf of institutions located in minor OECD countries. By sector, the value of facilities arranged for both financial institutions and industrial companies fell during the quarter.

Syndicated credits

The total value of announcements of syndicated credits fell from $24.6 billion in the first quarter to $22.1 billion in the second, the third consecutive quarterly fall. The volume of announcements did, however, remain well above the levels recorded in 1985 and 1986. During the second quarter, there was also a moderate reduction in the announcements of loans by companies in major OECD countries, which may reflect the fact that some of the demand for 'credit insurance' among large corporate borrowers has already been satisfied. On the other hand, as in previous quarters, the market demonstrated its ability to provide large takeover-related credits. Three such credits, each in excess of $1 billion, were announced during the quarter.

The syndicated credits market remained competitive, although some borrowers found that they had to pay higher margins than in the second half of last year, when spreads reached a low point. The need to maintain profitability, and the difficulty of raising new equity, combined with the more stringent capital adequacy ratios, are likely to reduce banks' ability to do business at very low spreads. However, the revival of the primary eurobond market, together with the swap opportunities that this has created, has given borrowers an alternative source of competitive funds, and this has moderated some of the pressures for lending rates to rise.

The proportion of credits denominated in US dollars rose to 68% during the second quarter. Sterling continued to be the second most important currency, maintaining its share of total announcements at approximately 18%. French franc loans accounted for 5% of total announcements, with yen and deutschemark-denominated facilities each representing less than 2% of all facilities.

Borrowers from major OECD countries, more particularly the United Kingdom, the United States and France, remained the most significant in the market, accounting for more than two thirds of all facilities, although there was a large increase in borrowing by Italian institutions. Credits arranged by both minor OECD countries and developing countries declined , the latter from $2.3 billion in the first quarter to $1.3 billion in the second. Eastern bloc borrowers announced that they had obtained credits worth $460 million during the quarter; included within this figure is a $150 million loan for Ceskoslovenska Obchodni Banca.

Announced eurocurrency syndicated credits

$ billions

	1986	1987			1988	
	Year	Year	Q3	Q4	Q1	Q2
Major OECD	11.6	60.6	22.3	19.4	16.8	15.3
Minor OECD	6.5	14.9	1.9	4.5	5.3	4.7
Developing countries	8.2	9.1	2.6	2.2	2.3	1.3
Eastern bloc	2.3	1.9	0.1	—	0.2	0.5
Other	1.2	1.4	—	0.1	—	0.3
Total	**29.8**	**87.9**	**26.9**	**26.2**	**24.6**	**22.1**
of which, transferable	*3.3*	*2.8*	*0.7*	*0.9*	*0.6*	*0.2*

International banking developments

The rate of growth of BIS reporting banks' cross-border business continued to fall in the first quarter of 1988; lending increased by 1.8% ($75 billion) compared with 4.0% in the previous quarter. New lending from within the BIS reporting area and offshore centres, three quarters of which was interbank, fully accounted for the overall increase. Similarly, the major part of the increase in deposits was from within the BIS reporting area and offshore centres, almost all of which was from other banks. New lending to final users was $50 billion compared with $80 billion in the fourth quarter.

New business was dominated by banks in Japan, which lent $58 billion and received deposits of $56 billion, in contrast to the previous quarter when they were substantial net takers (of $24 billion). Business in the Japan Offshore Market was at its highest level since its inception and accounted for nearly two thirds of Japanese banks' new lending. Although new cross-border lending to the non-bank sector within Japan was $1.7 billion, its lowest level since the fourth quarter of 1986, foreign currency lending to Japanese non-banks by Japanese banks recovered to $16.1 billion ($9.4 billion during the fourth quarter).

The external assets and liabilities of banks in the United States fell by $15.8 billion and $22.5 billion respectively, reversing the growth of the previous quarter. Overseas borrowing by US non-banks, however, continued to rise, by $8.9 billion. Banks in the United Kingdom were

Cross-border business of banks in the BIS reporting area

$ billions; changes exclude estimated exchange rate effects

	1985	1986	1987				1988	Out-standing at end-Mar.
	Year	Year	Q1	Q2	Q3	Q4	Q1	1988
Liabilities vis-à-vis:								
BIS-reporting area	176.9	384.9	78.9	154.0	141.7	118.7	50.6	2,831.7
'Offshore' centres	43.8	128.7	9.4	20.5	59.4	37.0	15.2	741.0
Sub-total	220.8	513.6	88.3	174.4	201.1	155.8	65.8	3,572.7
Outside reporting area								
Developed countries	3.2	7.2	2.7	0.6	2.9	-0.4	0.8	56.3
Eastern Europe	2.8	-0.1	-2.2	0.2	0.9	0.2	0.2	31.5
Oil exporters	7.6	-22.0	1.1	7.3	2.2	8.5	1.3	170.1
Non-oil developing countries	5.7	12.8	4.5	14.3	-1.7	7.0	3.6	231.4
of which, Latin America	*0.4*	*0.8*	*-1.0*	*5.3*	*0.3*	*1.9*	*1.6*	*80.3*
Sub-total	19.3	-2.1	6.1	22.5	4.4	15.4	5.9	489.3
Other(a)	2.5	31.1	18.1	3.4	5.9	8.0	11.1	202.5
Total	**242.6**	**542.7**	**112.5**	**200.3**	**211.4**	**179.2**	**82.7**	**4,264.5**
Assets vis-à-vis:								
BIS-reporting area	181.3	394.8	57.9	141.3	138.3	113.3	57.9	2,685.6
'Offshore' centres	24.3	96.0	16.3	31.8	57.4	32.2	19.7	700.3
Sub-total	205.6	490.7	74.1	173.1	195.7	145.4	77.6	3,385.9
Outside reporting area								
Developed countries	6.8	6.7	1.2	1.4	0.7	1.7	-0.8	127.9
Eastern Europe	5.7	3.4	-0.6	1.4	1.4	-0.1	3.0	85.1
Oil exporters	0.2	0.4	0.8	2.4	-0.9	-0.4	-1.0	124.6
Non-oil developing countries	11.1	3.1	—	0.9	-7.6	4.6	-2.2	378.3
of which, Latin America	*1.7*	*1.6*	*-0.5*	*1.3*	*-4.8*	*-3.6*	*-1.8*	*221.9*
Sub-total	23.8	13.5	1.3	6.1	-6.5	5.9	-0.9	716.0
Unallocated and international institutions	4.1	13.1	5.7	0.7	6.3	—	-1.3	104.7
Total	**233.5**	**517.3**	**81.1**	**179.9**	**195.5**	**151.3**	**75.3**	**4,206.6**

(a) Includes international institutions, unallocated and issues of securities.

net takers of $10 billion but the salient feature was the $2.7 billion fall in their external assets, the first such fall since the third quarter of 1984. UK banks' cross-border liabilities grew by only $7.3 billion, the smallest rise since the second quarter of 1985. Banks in Germany continue to be net borrowers, of $6.7 billion, for the third quarter running. Slow growth in new lending ($3.7 billion compared with $10.7 billion during the fourth quarter) contributed to French banks' being net takers of some $4.9 billion. Substantial net placements (mostly lending) were made by banks in the Netherlands ($5.9 billion) and Switzerland ($8.9 billion). Among the offshore centres, deposits and borrowing by residents of Hong Kong with banks in the BIS reporting area increased by $16.0 billion while banks withdrew $4.7 billion (12%) from Panama.

The stock of outstanding dollar-denominated cross-border lending fell marginally during the first quarter (this compares with the previous quarter when 63% of new lending was in dollars). Yen and sterling were the most popular currencies, accounting for 33% and 22% of new lending respectively.

Outside the BIS reporting area, all country groups with the exception of Eastern Europe (which borrowed an additional $3.0 billion) repaid borrowing and increased their deposits with BIS-area banks. The $3.6 billion increase in the non-oil developing countries' deposits, however, includes a $5.3 billion drawdown of deposits by Taiwan; major depositors were South Korea ($3.2 billion), China ($1.5 billion) and Mexico ($1.2 billion). Substantial repayments of past borrowings were made by Mexico ($1.8 billion, of which $1.0 billion can be attributed to the official debt conversion scheme) and Taiwan ($2.0 billion). The $0.9 billion decrease in recorded lending to countries outside the BIS reporting area contrasts with a rise of $5.9 billion in the fourth quarter.

The London market

In the first quarter of 1988, UK banks' external assets showed a slight fall ($3.3 billion, or less than one half of one per cent), the first fall since the second quarter of 1985. After being net suppliers of funds during the second half of 1987, UK banks reverted to being net takers (of $7.2 billion) from overseas residents. Increased sterling deposits outweighed falls in foreign currency deposits.

Lending to the industrial BIS reporting countries continued to increase but the $4.2 billion rise in the first quarter was substantially less than those seen during 1987. After being net takers of some $15.5 billion from UK banks during the second half of 1987, US residents were net providers of $12.1 billion during the first quarter. Of this, banks provided an exceptional net $20 billion, as earlier lending by banks in the United Kingdom was repaid; this was partly offset by US non-banks running down their deposits. As in the fourth quarter, banks in Switzerland also made substantial net placements, of $4.1 billion.

Japan remained a net taker of funds from London ($3.8 billion, around two thirds of which was attributable to the non-bank sector). Interbank lending to Japan rose by $9.9 billion and deposits from Japan by $8.5 billion (during the fourth quarter of 1987 banks in Japan had drawn down their deposits in London, with the result that Japan was also a net taker, of $11 billion, for that quarter). The expansion of interbank claims was, however, less than might have been expected in what has traditionally been a window-dressing quarter. Banks in Germany again ran down their deposits in the London market: this was partly offset by an increase in deposits from German non-banks. This contrasts with the previous quarter when Germany's position as a net taker was largely determined by non-bank activity.

The most striking feature of business with the offshore banking centres was the sharp reduction in UK banks' Panamanian assets and liabilities following the political upheaval in that country. Lending to Panama fell by $1.3 billion and Panama's deposits with banks in London were reduced by $2.0 billion. The Bahamas and the Cayman Islands were, however, the largest net takers ($2.5 billion and $1.8 billion respectively) while Hong Kong was the only substantial net placer, of $1.8 billion, largely because of reduced borrowing.

Both lending to and deposits from the non-BIS-reporting countries fell (by $2.4 billion and $2.5 billion). The 'other developed' countries made net placements of $2.1 billion, more than unwinding their unusual fourth quarter position. Eastern Europe was a net taker of $1.6 billion, of which $1.0 billion was attributable to the Soviet Union.

The oil exporters were modest net takers of $0.3 billion: the $0.8 billion reduction in their deposits was the first since the first quarter of 1987.

The non-oil developing countries reduced their deposits for the first time since 1986 and, overall, were slight net takers ($0.3 billion). Recorded lending to these countries, however, continued to fall (by $1.2 billion in the first quarter). Lending to Latin America fell by $0.6 billion, including a fall of $0.2 billion in lending to Brazil. Mexico was a net taker of $0.4 billion, reducing its deposits by a further £0.6 billion following a $1.0 billion fall during the fourth quarter. Among these countries, however, the most salient feature was a $3.5 billion reduction in Taiwan's deposits. China added $1.3 billion to its deposits in London.

The Japanese-owned banks' share of external claims remained stable at just below 40%, unchanged since 1986. Similarly, the British-owned banks' share remained unchanged at just under 16%, its level since end-June 1987. The end-March figures show a further reduction, of just under one percentage point, in the US-owned banks' share during the past six months.

Following expansion during 1987, dollar-denominated lending fell slightly during the first quarter of 1988. There were also falls in deutschemark and Swiss franc assets, the latter continuing a trend commencing in the second quarter of last year; sterling, yen and the minor currencies took an increased share of new lending.

In the second quarter of 1988, UK banks' international assets fell by $6.1 billion. This fall was more than accounted for by foreign currency claims on UK residents; external lending rose by $10.6 billion. External liabilities rose by $19.3 billion following two quarters of slow growth, so that there were net inflows from overseas residents to banks in the United Kingdom.

The fall in total international lending was entirely attributable to the Japanese banks; although the second quarter is normally one of slower growth, this fall of $10.6 billion more than offset the moderate rise in the previous quarter. By far the greater part of this was a continuation of the trend of a reduction in business with other banks in London; the only area to show growth was lending to unrelated banks overseas.

British banks increased their external lending more strongly than for several quarters and they were also the major recipients of the inflow of deposits from overseas residents. American banks' external lending was mainly to their own offices overseas, which was also their major source of funds. The main stimulus to growth overall came from other overseas banks; even they reduced their lending in foreign currency to other banks in London, although this was more than offset by lending to unrelated banks overseas.

Cross-border business of banks in the United Kingdom

$ billions; changes exclude estimated exchange rate effects

	1985	1986	1987				1988	Outstanding at end-Mar.
	Year	Year	Q1	Q2	Q3	Q4	Q1	1988
Liabilities vis-à-vis:								
BIS-reporting area	39.2	69.6	11.2	23.3	16.1	4.9	9.4	599.8
of which:								
United States	*11.1*	*12.4*	*1.3*	*10.5*	*8.9*	*- 7.9*	*- 1.6*	*162.2*
Japan	*8.2*	*28.4*	*2.3*	*4.5*	*9.7*	*- 2.8*	*8.8*	*90.1*
'Offshore' banking centres	4.5	10.1	- 1.4	2.4	3.1	1.1	- 3.8	115.8
Sub-total	43.7	79.6	9.8	25.7	19.2	6.0	5.5	715.6
Outside reporting area								
Developed countries	1.2	0.2	0.8	1.8	1.3	-0.9	0.5	20.1
Eastern Europe	1.2	—	- 1.1	0.1	0.3	0.5	-0.7	7.8
Oil exporters	1.3	- 8.5	- 2.6	2.2	—	0.7	-0.8	46.8
Non-oil developing countries	- 1.2	2.1	1.7	5.9	0.4	0.6	-1.5	51.8
of which, Latin America	*- 2.2*	*- 0.5*	*0.2*	*3.0*	*0.5*	*- 0.7*	*- 0.3*	*7.9*
Sub-total	2.5	- 6.2	- 1.2	10.1	2.0	1.0	-2.5	126.5
Other(b)	- 5.8	19.6	8.3	- 1.2	0.8	7.2	0.9	80.7
Total	**40.4**	**93.0**	**16.9**	**34.5**	**22.1**	**14.2**	**3.9**	**922.8**
Assets(a) vis-à-vis:								
BIS-reporting area	29.0	69.0	12.1	20.2	26.2	22.1	4.2	595.4
of which:								
United States	*15.1*	*14.3*	*5.2*	*7.4*	*5.2*	*1.3*	*-13.7*	*127.0*
Japan	*16.9*	*50.0*	*8.3*	*14.4*	*7.6*	*8.2*	*12.6*	*183.2*
'Offshore' banking centres	- 8.1	7.5	0.2	4.2	3.1	- 2.2	- 2.9	116.5
Sub-total	20.9	76.5	12.4	24.4	29.3	19.9	1.2	712.0
Outside reporting area								
Developed countries	2.2	1.0	- 0.5	- 0.1	- 1.0	0.2	- 1.6	35.4
Eastern Europe	3.3	2.4	- 0.4	0.6	0.9	- 0.5	0.9	22.3
Oil exporters	- 0.5	- 0.1	- 0.2	0.3	- 0.4	- 0.3	- 0.5	20.0
Non-oil developing countries	2.7	- 0.9	—	- 0.5	- 1.2	- 0.7	- 1.2	55.3
of which, Latin America	*1.4*	—	*0.5*	*- 0.2*	*- 0.5*	*- 1.1*	*- 0.6*	*34.6*
Sub-total	7.7	2.5	- 1.1	0.3	- 1.7	- 1.3	- 2.4	133.0
Other(c)	1.6	7.2	1.5	- 1.1	0.9	3.3	- 2.2	15.9
Total	**30.2**	**86.2**	**12.8**	**23.6**	**28.5**	**21.9**	**- 3.3**	**860.9**

(a) Including securitised lending from the first quarter of 1986.

(b) International organisations, unallocated and international issues of securities.

(c) International organisations and unallocated.

Foreign exchange and gold markets

This section reviews the three months to end-June

The dollar continued to be strongly influenced by US trade figures. In a nervous beginning to the quarter the dollar suffered from news of an increased trade deficit in February, but with the March and April figures revealing significant improvements, advanced strongly thereafter, particularly towards the end of June.

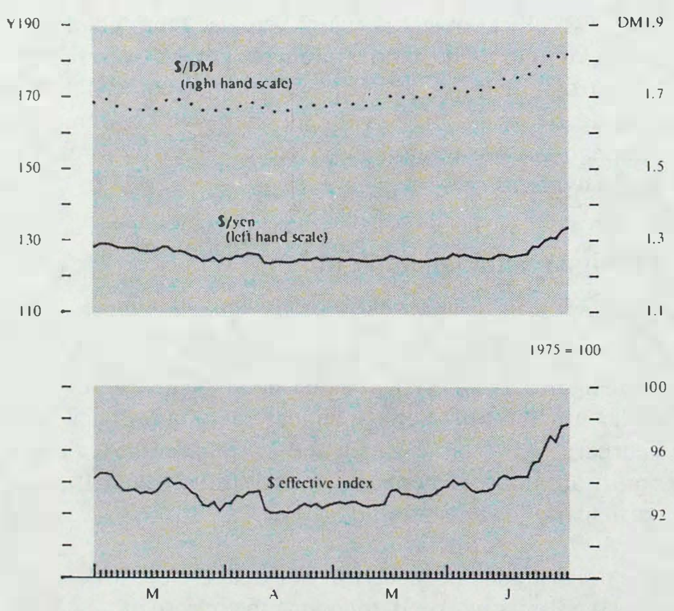
The dollar traded nervously in Tokyo and New York over the Easter weekend, following the release of stronger-than-expected US employment data (a rise of 262,000 in non-farm payrolls) suggesting that there was little scope for more improvement in the trade deficit in the short term. However, it opened in London on 5 April on a firmer note at DM1.6572 and ¥124.37, helped by rumours of central bank intervention and a slight tightening of US monetary policy by the Federal Reserve. With Japan's March trade surplus lower than expected and the meeting of G7 ministers on 13 April expected to be supportive of exchange rate stability, the dollar edged up steadily to ¥127.05 and DM1.6935 on 11 and 13 April respectively. However, the publication on 14 April of an increased US trade deficit of $13.8 billion in February (from $12.4 billion in January) caused the dollar to fall sharply.

Concerted central bank intervention steadied the fall, but it dipped to lows for the period of ¥123.50 on 14 April and DM1.6570 on 18 April. Increased tension in the Gulf subsequently sparked a rally and the dollar touched DM1.6802 and ¥125.40 on 27 April. However, its failure to breach previous highs triggered some sizable technical selling, which was encouraged by concerns that interest rates in Germany might rise following a slight increase in inflation there; as a result, the dollar eased a little to DM1.6670 and ¥124.45 on 29 April.

The dollar was restricted to a narrow range for much of May. The impact of a ½% increase in US prime rates (to 9%) on 11 May tended to be offset by a statement from Governor Angell that assumptions about further tightening by the Federal Reserve 'might very well be mistaken' and it took news of a significant reduction in the US trade deficit (from $13.8 billion in February to $9.75 billion in March) to lift the dollar, which advanced strongly from DM1.6837 and ¥124.77 before publication of the figures on 17 May to DM1.7070 and ¥126.25 in its immediate aftermath. Although subsequently surrendering some ground to the yen—which benefited

Dollar exchange rates

At the close of business in London each day



from cross-currency trading against the deutschemark and the Swiss franc—the dollar consolidated its gains against most currencies. A smaller rise of 0.4% in US consumer prices in April (from +0.5% in March) allayed some fears about inflation and, with a further boost being provided by an upward revision to GNP growth for the first quarter (to 3.9% from an earlier estimate of 2.3%), the dollar ended the month on a firm note amid rumours of an imminent increase in discount rate.

Although that increase failed to materialise, the dollar benefited from sterling's weakness, touching DM 1.7335 and ¥126.72 on 2 June. An unexpected jump (from 5.4% to 5.6%) in US unemployment in May was balanced by strong non-farm payroll data and had little effect. However, press reports of large sales of dollars by the Bundesbank subsequently tempered market demand and, encouraged by comments from Bundesbank President Poehl that Germany did not seek a further weakening of the deutschemark, a feeling developed that central banks did not, for the most part, wish to see the dollar higher. As a result, the dollar traded quietly during the first half of June as cross-currency trading became the dominant feature.

However, publication (on 14 June) of an improvement in the US trade deficit to a seasonally-adjusted $9.9 billion in April (from a revised seasonally-adjusted figure of $11.7 billion in March) surprised the market and the dollar advanced strongly (to DM 1.7548 and ¥126.40 the following day). An element of caution ahead of the Toronto economic summit prevented the dollar from making further gains in the ensuing week; fears of co-ordinated central bank intervention and a small downward revision to US GNP growth in the first quarter contributed to the easier tone. However, the dollar resumed its recovery on 24 June, advancing strongly in New York that evening and reaching DM 1.8285 (a high for the period) and ¥131.65 on 27 June. Reports of concerted intervention subsequently restricted the dollar to modest further gains against European currencies, but, with the Bank of Japan reportedly prepared to allow the yen to weaken, the US unit continued to advance strongly against the Japanese currency. After touching a high of ¥133.95 on 30 June, the dollar ended the quarter on a firm note at DM 1.8202 (up 9.7%), Sw.Fc. 1.5115 (up 10.7%) and ¥133.77 (up 7.8%); in effective terms, it rose by 6% to 97.7 (1975 = 100).

EMS

The exchange rate mechanism was free from pressure for much of the period in spite of some nervousness over the outcome of elections in France. The French franc briefly replaced the Belgian franc in the lowest position following the better-than-expected performance of the National Front in the first round of the French presidential election in April, and weakened again in early May prior to the final round of the election. Following President Mitterand's victory, however, the tension subsided and confidence in the French franc revived, enabling the Banque de France to announce ¼% reductions in key interest rates and increases in minimum reserve requirements at the end of May. The Italian lira also experienced a period of pressure at the beginning of May, but it was subsequently helped by the easier tone of the deutschemark and recovered well.

The Danish krone strengthened following the inconclusive general election of 10 May and again at the beginning of June when Poul Schluter emerged as the leader of the new coalition government; it eventually displaced the Dutch guilder as the strongest currency within the EMS in mid-June. In response to the krone's strength, Danmarks Nationalbank cut its key current account lending rate from 9% to 8¾% on 16 June. Nevertheless, the krone remained close to the top of the system and, although the Irish punt occupied the highest position for a short period, the krone quickly replaced it and remained at the top for the rest of the period. The narrow band ended the quarter 2% wide between the krone and the Belgian franc.

Gold

The gold price fluctuated over the period as conflicting forces influenced the market. Having opened at $456.00 on 5 April, gold initially lost ground as the dollar rallied, falling to $446.25 on 7 April. However, helped by a rise in silver futures, increased tensions in the Gulf and higher oil prices, it gradually recovered its losses, reaching $458.00 on 18 and 20 April. A fall in platinum prices and rumours of producer selling were responsible for a subsequent period of weakness and, when OPEC failed to agree about oil production cuts, gold fell sharply to $441.95 on 4 May.

Firmer silver and platinum prices, and a technical squeeze on the futures markets, sparked a recovery and, amid talk of embargoes on South African platinum exports, gold was carried up to a high for the period of $464.85 on 3 June. However, a fall in US agricultural futures (indicating a lessening of inflationary pressures) led to a renewed decline and, with lower oil prices and the firmer dollar contributing to the easier tone, gold fell back sharply to $450.50 on 13 June. As the dollar's recovery gathered momentum, gold suffered from speculative selling, falling to a low for the period of $433.55 on 29 June and ending the quarter with a final fixing of $436.55 (down 4.3%).