International financial developments

Among the main developments:

- *The US current account deficit widened again in the first quarter, as did the German surplus: more recent data suggest that some adjustment in the trade imbalance in Germany has taken place. Little further progress was apparent in Japan in the first quarter, although the surplus has fallen back more recently. The short-run effects of dollar strength may be partly responsible for recent encouraging movements.*
- *Overall financing activity in the primary international capital markets fell back in the second quarter, reflecting a lower volume of straight fixed-rate bond issues — in part on account of rising interest rates — and a reduction in arrangements of new syndicated credit facilities from their exceptionally high first quarter level.*
- *In the foreign exchange markets, the US dollar strengthened further for much of the second quarter, but fell back sharply in the final two weeks of the period as expectations of an easing of US monetary policy became more widespread: over the quarter as a whole it appreciated by 4½% in effective terms.*

Balance of payments positions

Current accounts

During 1988, there was some adjustment in the US current account deficit, in both nominal and real terms, although these movements were concentrated in the first part of the year as the effects on trade flows of post-Plaza dollar depreciation unfolded. More recent data, however, indicate that trade adjustment is still continuing, though at a slower pace than before. In this context, the appreciation of the dollar in the middle of last year and again in the first half of 1989 is not helpful in the longer term, although it may give rise to better figures in the short term. Rising domestic demand, higher oil prices and the short-run effects of a weaker yen have all contributed to a decrease in the Japanese surplus so far in 1989.

The *US* current account deficit increased to $31 billion in the first quarter of 1989 from $29 billion in the previous quarter and was associated with a decrease in net invisible receipts, which reflected lower dollar earnings from US direct investment abroad owing to the appreciation of the currency. The merchandise trade deficit meanwhile decreased to $28 billion in the first quarter from $31 billion in the fourth quarter of 1988. Export volumes rose while imports declined, the latter partly reflecting the relative slowdown of US domestic demand. Both receipts and payments on portfolio investment increased, mostly because of higher interest rates.

Very little change was recorded in the current account position of *Japan*. The current account surplus remained at $21 billion in the first quarter while the trade surplus rose to $27 billion (from $25 billion in the fourth). The

World current accounts[a]
$ billions; *seasonally adjusted*

	1987	1988(b)					1989
	Year	Year	Q1	Q2	Q3	Q4	Q1
OECD economies:							
United States	-154	-135	-37	-34	-33	-29	-31
Japan	87	80	22	17	18	21	21
Germany	45	49	10	15	12	11	16
France	-4	-4	1	—	-1	-4	..
United Kingdom	-5	-26	-5	-5	-6	-10	-8
Italy	-2	-5	-5	1	—	-1	..
Canada	-8	-8	-1	-2	-2	-3	-3
Major economies	-41	-49	-15	-7	-11	-14	..
Other OECD	-16	-23	-6	-8	-7	-2	-8
Total OECD	-57	-72	-22	-15	-18	-16	..
OPEC economies	-10	-22	-4	-6	-6	-6	-4
Non-OPEC developing economies	12	4	3	—	—	1	-1
Other economies(c)	8	9	2	2	2	3	3
World discrepancy(d)	-47	-81	-21	-19	-22	-18	..

(a) Partly estimated: components may not add exactly to totals because of rounding.
(b) Includes Bank estimates.
(c) The centrally planned economies.
(d) 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).

deficit on invisibles rose to $5.0 billion in the first quarter from $4.2 billion in the fourth. As a percentage of GNP, the current surplus remained at 2.9%. More recently, the surplus has fallen back quite markedly.

On the other hand, *Germany's* current account surplus continued to grow as strong external demand had a positive effect on exports while import volumes fell despite somewhat stronger domestic demand growth. In addition, the depreciation in the exchange rate of the deutschemark during the first quarter reduced net invisibles payments, while investment income receipts rose sharply owing to earlier capital exports. The current account surplus rose to $16 billion in the first quarter ($11 billion in the fourth) with a more marked rise in local currency terms. As a percentage of GNP, the current surplus rose to 5% (4% in the fourth quarter).

In *Canada* and the *United Kingdom*, high interest rates induced some slowing in consumer spending which led to some improvement in these countries' merchandise trade balances. However, in Canada an improvement in the merchandise trade surplus was largely offset by higher interest payments. Overall the current account deficit in Canada was $3 billion in the first quarter (the same as in the fourth).

The current account deficit in the United Kingdom declined to $8 billion in the first quarter, from $10 billion in the fourth. Export volumes rose by 2.8% after declining in the previous two quarters while import volumes rose by 2.4%. Although the growth of imports was faster than in the fourth quarter, it was much lower than in the previous two quarters. The non-oil trade deficit fell slightly in the first quarter.

Capital accounts

Whereas in 1987 the pattern of *US* external financing flows had been notable for large scale official purchases of US assets and exchange market intervention, in 1988 private financing flows were the main counterpart to the slightly smaller current account deficit, encouraged by perceptions of greater stability in foreign exchange markets. This meant that interest rate differentials played a powerful role in attracting private capital flows.

Latest quarterly data indicate that this process has continued. Portfolio investment inflows by foreign residents were $17 billion in the first quarter ($12 billion in the fourth) while official purchases of US equity and bonds slowed to $7 billion from $11 billion in the previous quarter, although some of the latter could have been a result of switching from earlier intervention. Also, as a higher proportion of the US current account deficit was financed by longer-term inflows such as direct investment and long-term bond purchases, this may have contributed to the market's perception of the improved sustainability of the US deficit. The increase in foreign purchases of US bonds relates in part to pessimism about equity markets after the October 1987 crash, favourable interest rate differentials particularly for Japanese investors, and possibly greater confidence in the ability of the United States to contain inflation. Flows through the banking system, however, recorded net outflows of $12 billion in the first quarter after an inflow of $1 billion in the fourth. In total, net capital inflows into the United States exceeded the current deficit: and, together with intervention to moderate the rise in the dollar, this led to a rise in exchange reserves of $4 billion in the first quarter of the year.

External financing of the G7 countries

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

	1987	1988				1989
	Year	Year	Q2	Q3	Q4	Q1
Identified current account						
United States(a)	-154	-135	-35	-39	-30	-31
Japan	87	80	19	19	24	16
Germany	45	49	14	9	16	16
France	-4	-4	—	—	-3	..
United Kingdom	-5	-26	-6	-6	-8	-8
Italy	-2	-5	1	—	-1	..
Canada	-8	-8	-1	—	-3	-5
Financed by:						
Portfolio investment						
United States(a)	75	78	22	7	20	22
Assets	-5	-8	1	-2	-3	-3
Liabilities	80	86	21	9	23	24
of which:						
From official sector	45	39	6	-2	11	7
From private sector	35	47	15	11	12	17
Japan	-97	-65	-25	-19	-14	7
Germany	5	-37	-11	-8	-9	-15
France	5	8	6	-1	3	..
United Kingdom	28	-12	-7	4	-5	-13
Italy	-4	—	-1	-1	1	..
Canada	9	10	3	4	1	5
Direct investment						
United States(a)	-3	41	16	7	14	11
Japan	-18	-35	-8	-9	-10	-9
Germany	-7	-9	-4	-2	-1	-1
France	-4	-6	-1	-1	-3	..
United Kingdom	-15	-13	-6	-4	-4	-4
Italy	2	1	—	2	—	..
Canada	-1	-3	-2	—	-1	-1
Banking sector						
United States(a)	51	14	18	-3	1	-12
Japan	80	47	23	21	8	-14
Germany	-4	-4	-3	-6	-2	13
France	-11	3	-3	2	-1	..
United Kingdom	4	26	10	1	11	14
Italy	4	8	2	-1	5	8
Canada	2	2	-3	4	—	-3
Other(b)						
United States(a)	21	-3	-23	29	-9	14
Japan	-12	-11	-5	-9	-2	2
Germany	-21	-17	-2	-4	-3	-17
France	14	-1	-1	-2	-1	..
United Kingdom	7	31	10	7	8	9
Italy	4	4	-3	3	—	..
Canada	2	6	6	-9	4	4
Official financing balance (– = increase in reserves)						
United States(a)	9	-4	—	-7	2	-4
Japan	-39	-16	-3	-4	-7	-2
Germany	-18	18	5	11	—	5
France	—	1	—	2	5	..
United Kingdom	-20	-5	-1	-2	-1	1
Italy	-5	-7	—	-3	-3	-5
Canada	-3	-8	-4	2	-1	—

.. not available.

(a) Seasonally adjusted.

(b) Includes balancing item reflecting unidentified net flows which may be associated with either the current or the capital account.

The *Japanese* current surplus continued to be deployed in long-term capital outflows and rising reserves. Direct investment abroad continued strongly in the first quarter ($9 billion). A desire by Japanese exporters to avoid tariff and other protectionist barriers, as well as capacity and labour cost constraints at home, were the main factors underlying direct investment in Europe, the United States and the SE Asian economies. The growth of net portfolio investment abroad declined in 1988 and net inflows were recorded in the first quarter of 1989, largely owing to the strength and buoyancy of the Japanese stock market. Finally, capital flows through the banking system recorded a very marked reversal from large net inflows in 1988 to net outflows of $14 billion in the first quarter of 1989. Those movements were mainly the result of a decrease in short-term borrowing in foreign currency and perhaps related to reduced hedging activity as confidence in the stability of exchange rates increased.

Despite the continued large current surplus in *Germany*, reserves fell by $5 billion in the first quarter of the year, reflecting massive capital outflows and intervention by the monetary authorities to support the deutschemark. German residents' net purchases of foreign securities were $15 billion in the first quarter ($9 billion in the fourth) while net foreign investment in securities recorded a deficit of $3 billion ($4 billion surplus in the fourth quarter) owing to large net sales of bonds. Investors were motivated by the attraction of significant interest rate differentials in favour of some other countries and the desire to avoid the withholding tax which was introduced in January 1989 (subsequently abolished in July) on domestic interest income.

The *Canadian* current deficit was financed entirely by purchases of Canadian bonds and money-market instruments, largely Government of Canada securities, by overseas residents: such purchases totalled $5 billion in the first quarter ($1 billion in the fourth). Other capital inflows were used largely to finance direct investment in Canada.

The current account deficit in the *United Kingdom* was financed largely by purchases of short-term deposits through the banking system by the foreign private sector. Direct and portfolio investment continued to record large net outflows. Net bank liabilities rose to a record quarterly inflow of $14 billion. Additionally, non-bank flows, which are transactions with residents and banks abroad, switched from net outflows of $1.9 billion in the fourth quarter to net inflows of $3 billion in the first quarter of 1989. Furthermore, the statistical discrepancy is believed to reflect mostly unrecorded capital inflows, probably of a short-term nature.

The growing *Italian* current account deficit seems to be more than financed by inflows through the banking system. Net bank liabilities rose by $8 billion in the first quarter of 1989 after increasing by $5 billion in the last quarter of 1988. These inflows were larger than the current deficit (and other outflows) and, consequently, reserves rose by $3 billion in the fourth quarter and a further $5 billion in the first quarter of 1989.

Oil exporting countries continued to run a current account deficit ($3.7 billion) in the first quarter, but at a lower level than of late. Within the movements in external assets so far identified, net disinvestment of $2.6 billion from the United Kingdom (including the disposal of shares in BP by the Kuwait Investment Office) was outweighed by substantial net investment of $7.3 billion in the United States.

International capital markets

Overall financing activity in the primary international capital markets declined from $133 billion in the first quarter of 1989 to $114 billion in the second. Activity nevertheless remained above the quarterly average for

Identified deployment of oil exporters' funds[a]

$ billions

	Mar. 1988 levels	1988 Q2	1988 Q3	1988 Q4	1989 Q1	Mar. 1989 levels
Industrial countries						
United Kingdom:						
Sterling bank deposits	10.6	2.2	0.4	0.7	0.6	13.1
Eurocurrency bank deposits	36.0	1.5	1.9	1.4	1.1	41.4
Government paper	7.3	-1.2	-0.6	-0.3	-0.1	4.5
Other investments	13.1	0.1	2.2	-0.1	-4.2	11.2
	67.0	2.6	3.9	1.7	-2.6	70.2
Other EEC:(b)						
Domestic currency bank deposits	7.3	0.2	-0.2	-0.3	-0.1	6.1
Eurocurrency bank deposits	21.4	-0.7	0.3	-0.3	—	20.2
Other investments	64.7	-0.6	-1.7	-1.2	-0.6	65.3
	93.4	-1.1	-1.6	-1.8	-0.7	91.6
United States:						
Bank deposits	18.5	-1.1	2.9	-3.2	0.8	18.0
Government paper	19.6	-1.1	0.3	2.6	5.8	27.1
Other investments	21.5	-0.6	-0.4	-0.6	0.7	20.6
	59.6	-2.8	2.8	-1.2	7.3	65.7
Other:						
Domestic currency bank deposits	6.0	2.3	-1.2	-0.8	-1.4	4.3
Eurocurrency bank deposits	32.9	-1.6	0.6	1.8	1.2	34.7
Other investments	46.9	-1.4	-1.7	-1.3	-1.7	38.1
	85.8	-0.7	-2.3	-0.3	-1.9	77.1
Offshore centres:						
Bank deposits	48.3	1.7	1.3	0.5	0.8	52.7
Placements with ldcs	59.5	—	—	—	—	59.5
OEC credit to non-banks	12.8	0.1	—	0.1	—	13.0
IMF and IBRD(c)	39.8	—	—	—	—	36.7
Total identified additions(+)/reductions (-) in deployed assets	**466.2**	**-0.2**	**2.0**	**-1.3**	**2.9**	**466.5**
Net funds available for deployment		-4.0	-3.1	-2.7	-7.7	
of which:						
Net movements in external borrowing etc		*2.0*	*3.3*	*2.8*	*-4.0*	
Current balance		*-6.0*	*-6.4*	*-5.5*	*-3.7*	

(a) The oil exporting countries covered are defined in the notes and definitions to Table 16 of the statistical annex in the February 1989 *Bulletin*.

(b) Includes Spain and Portugal.

(c) Includes holdings of gold.

1988, despite bearish factors such as rising interest rates in certain sectors. The decline over the quarter reflected reductions in issuance of fixed-rate bonds and arrangements of new syndicated-credit facilities. In contrast, issuance of FRNs and announcements of new euronote programmes increased.

Eurobond markets

(i) Fixed-rate bonds

Issuance of fixed-rate bonds declined from $75.8 billion in the first quarter to $62.3 billion in the second. The decline partly reflected higher inflation and rising interest rates in some of the major countries. The decline was concentrated in the straight sector where issuance fell from $51.2 billion to $34.6 billion. In contrast, issuance of equity-related bonds remained very buoyant. Borrowers from the United States, Germany, Japan and France increased their fixed-rate financing activity while Canadian and UK borrowers' activity fell. Borrowing by supranational institutions fell sharply.

The eurodollar sector was initially subdued by uncertainty over economic prospects in the United States, some fears of oversupply and renewed concerns over event risk following rumours of sizable leveraged buyouts. Dollar swap spreads were also reported to be unattractive

Total financing activity: by euromarket sector[a]

$ billions, at quarterly rates, by announcement date

	1987	1988			1989	
	Year	Year	Q3	Q4	Q1	Q2
Fixed-rate bonds						
Straights	29.3	40.0	35.5	34.5	51.2	34.6
Equity-related	10.8	10.5	14.1	5.1	24.6	27.5
Bonds with non-equity warrants (currency, gold, debt)	0.9	0.3	0.1	0.2	—	0.2
Total	**41.0**	**50.8**	**49.7**	**39.8**	**75.8**	**62.3**
Floating-rate notes	3.0	5.8	7.0	6.9	3.4	7.3
Euronote facilities	18.2	19.2	23.6	14.7	12.7	19.0
Syndicated credits	22.2	26.0	26.5	30.2	41.1	25.2
Total	**84.4**	**101.7**	**106.9**	**91.6**	**132.9**	**113.8**

(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.

throughout the quarter, reflecting pressure from the volume of Japanese equity-warrant issues (normally swapped from dollars to yen) and expectations of declines in US long rates. However, the rise in the dollar and accumulating evidence of a slowdown in US economic growth, with consequent easing of inflationary pressures, eventually led to an improvement in sentiment, the US long bond yield declining to just over 8%. Hopes of some easing in US monetary policy also eased rates at the short end. There was consequently an increase in issuance at the end of the quarter, the outturn being $14.0 billion compared with $19.3 billion in the first quarter. There was also a recovery in secondary market trading, linked to the rise of the dollar. Important developments included a eurobond backed by credit-card receivables and a BBB-rated high-yielding issue protected by covenants enabling investors to put the paper at par in the event of a takeover.

Dollar-denominated equity-warrant issues totalled $21.5 billion compared with $20.1 billion in the first quarter. Activity was strong at the start of the quarter, partly reflecting new Japanese accounting rules which increased the attraction of capital gains relative to interest receipts for certain institutional investors. However, the primary market experienced a lull towards the end of the quarter, which may have been related to uncertainty over the direction of the equity market and a saturation of investors' portfolios following an oversupply of bonds. The quarter was notable for several exceptionally large issues, including four $1.5 billion issues and one $1 billion issue.

At the end of the quarter, the first yen-denominated equity-warrant issue was made on the Japanese domestic market, prompted by earlier easing of regulations relating to minimum maturities and permitting separate sale of warrants from bonds with equity warrants attached in the primary market.

Currency composition of fixed-rate bond issues

Percentages of total issues announced

	Straight bonds			Equity-related bonds		
	1988	1989		1988	1989	
Currency denomination	Year	Q1	Q2	Year	Q1	Q2
US dollars	30	38	40	69	82	78
Swiss francs	11	5	2	20	13	16
Yen	12	12	12	—	—	—
Deutschemarks	13	9	7	2	2	3
Sterling	7	9	8	5	2	1
Australian dollars	5	7	4	1	—	—
Canadian dollars	8	10	5	—	—	—
ECU	7	5	9	1	—	1
Other	8	6	13	2	2	1

Total issuance in the Swiss franc sector, at $5.4 billion, was similar to the first quarter. The majority of Swiss franc issues ($4.4 billion) were equity related, including the largest-ever issue ($0.5 billion), by Fuji Corporation. In contrast, the Swiss franc straight market was subdued. Volume in the deutschemark market fell sharply from $4.7 billion to $3.5 billion, despite the announcement that the withholding tax, which had previously dampened issuance, would be abolished in July. A combination of some weakening of the currency and monetary tightening was thought to be responsible for the decline in issuance. There were nonetheless several innovative deutschemark issues, including dual-currency bonds.

Euroyen issuance declined from $6.0 billion to $4.1 billion, as political scandals, currency and interest rate uncertainty combined to render the market less attractive. In addition, swap spreads were often unfavourable and market liquidity was considered inadequate. There was, however, a small flurry of short-term issues when the rules relating to minimum maturity of issues by non-residents were liberalised in mid-June.

In the ECU sector issuance rose from $2.8 billion to $3.2 billion equivalent. Uncertainty in the deutschemark sector, attractive swap spreads and the interest of Japanese investors led a wide range of issuers to tap the market, including European national and supranational entities as well as several non-European corporations. The announcement of the reweighting of the ECU at the end of the quarter, which gave the Spanish peseta a weight of 5.3% and the Portuguese escudo 0.8%, had largely been discounted by the markets and therefore had little effect on yields.The entry of the peseta to the ERM, together with the recent liberalisation of rules governing issuers permitted to tap the europeseta (matador) market, prompted several issues over the quarter. The attraction for investors was in the high yield combined with a perceived linkage to the deutschemark.

Among the high-yielding currencies, issuance in the sterling market fell from $5.3 billion to $3.0 billion equivalent and maturities shortened, owing to the increase in domestic rates followed by uncertainty over the possibility of further increases. A £400 million issue for Italy was the largest-ever foreign government issue in the sterling market. Several issues were fungible with previous tranches, a feature that has become a key characteristic of the eurosterling market. Issuance in the Canadian and Australian dollar markets declined, the latter reflecting a continuing response to the sharp fall of the Australian dollar in February. It may also reflect the change in Japanese accounting rules earlier in the year, which reduced the relative attractiveness of high-yielding issues.

(ii) Floating-rate notes

Issuance of floating-rate notes doubled over the quarter, rising from $3.4 billion to $7.3 billion. The largest FRN over the quarter was in the deutschemark sector, with Dresdner Bank issuing bonds worth DM 1 billion. However, the eurosterling and eurodollar sectors continued to account for the bulk of FRN issuance. Demand for FRNs was boosted by flat or inverse yield curves and expectations of further increases in money-market rates due to inflationary pressures.

Sterling issues more than doubled to $2.9 billion. Issuance was largely by UK building societies (which issued $1.2 billion) and issuers of mortgage-backed securities ($1.6 billion). Mortgage-backed issues included the first issue based on the collateralised mortgage obligations structure popular in the United States, offering three tranches of different maturities. Meanwhile, Abbey National Building Society made the first sterling FRN issue with a maturity of under five years since the liberalisation announced in the Budget. In the eurodollar FRN market issuance totalled $1.8 billion; the recent call of $1 billion in outstanding issues buoyed demand in this sector. Dollar issues included the first FRN to be backed by coupons from a portfolio of 'junk' bonds.

(iii) Structural developments

During the quarter, the eurobond market underwent various reforms of its regulatory structure and issuance rules. Banks involved in the underwriting and distribution of eurobonds agreed new procedures which seek to overcome certain problems surrounding the price stabilisation of new issues. In future, co-managers will be allocated a set number of bonds at an agreed price by the lead managers and stabilisation costs can no longer be deducted by the lead manager from fees paid to co-managers. The move is designed to remove uncertainty with respect to allocation and stem some of the losses that participants have experienced in the market. Meanwhile, the Association of International Bond Dealers (AIBD) decided to seek the status of the recognised authority for international bond trading in all the major centres (currently it has the status of a regulatory body only in the United Kingdom).

Further deregulation of markets was a marked feature of the quarter. Minimum maturities were reduced in the deutschemark and yen sectors, and the Japanese liberalised the domestic equity-warrant market, while bond markets were liberalised in Norway and Sweden following abolition of exchange controls. Another factor common to several markets was an effort by bond issuers to reduce borrowing costs by adding liquidity through new tranches fungible with previous issues. Borrowers involved included the European Investment Bank (EIB), and Deutsche Bank. In a similar vein, Finland launched a bond which was exchangeable with some of its previous bond issues on attractive terms. In addition, the World Bank plans to launch a 'global bond' simultaneously in the eurodollar and US domestic markets.

Euronotes and other facilities

The volume of euronote facilities increased strongly in the second quarter, with arrangements totalling $19.0 billion, compared with $12.7 billion in the first. Eurocommercial paper (ECP) continued to account for the bulk of announcements (69%), euro medium-term notes (EMTNs) made up 16% and note issuance facilities/revolving underwriting facilities (NIFs/RUFs) represented the balance. The stock of euronotes outstanding fell from $80.9 billion to $77.8 billion.

Announced euronote facilities[a]
$ billions

	1987	1988			1989	
	Year	Year	Q3	Q4	Q1	Q2
Committed(b)	3.9	3.7	1.6	0.1	0.6	0.9
Uncommitted	69.0	74.7	22.1	15.3	12.1	18.1
Total	**73.3**	**78.4**	**23.7**	**15.3**	**12.7**	19.0
of which:						
Major OECD	*47.6*	*44.3*	*14.8*	*7.9*	*9.5*	*8.5*
Minor OECD	*23.6*	*28.0*	*5.3*	*7.1*	*2.9*	*8.3*
Other	*2.1*	*6.1*	*3.6*	*0.3*	*0.3*	*2.2*
Selected nationalities of borrower						
United States	16.0	9.8	3.7	0.8	3.1	2.6
United Kingdom	10.0	11.4	2.9	1.8	0.4	2.7
Australia	8.5	6.0	1.7	1.0	1.5	4.4
Japan	10.0	6.5	2.0	2.2	2.1	2.1

(a) Includes all facilities providing for the use of euronotes (including note issuance facilities, revolving underwriting facilities, multiple-option facilities which incorporate a note issuance option,eurocommercial paper programmes and euro medium-term note programmes).

(b) Underwritten or otherwise backed by bank commitments.

The US dollar accounted for 88% of the total of euronote facilities, although such a statistic is becoming increasingly misleading owing to the growth in facilities incorporating multicurrency options or involving the currency swap market. Much of the growth over the quarter reflected a substantial increase in borrowing (mainly by corporations) in smaller OECD countries, borrowers from which increased their share of the market from 23% to 44%.

The second quarter saw the return of international institutions to the euronotes market, with the announcement of the largest-ever supranational global MTN programme, on behalf of The Council of Europe, for US$1 billion. Similar, but smaller, facilities were later arranged on behalf of the European Community and the ECSC. Global programmes have increased in popularity to all groups of borrowers over the last twelve months as they allow the borrower to gain access to medium-term funds in either the US or euro markets depending on which offers the lowest cost of funds at the time. It was hoped that the programmes on behalf of the three European institutions would provide benchmarks and greater liquidity to the EMTN market.

A recent default in the eurocommercial paper market has focused market attention on the need for programmes to be rated and for more regular reviews of existing credit ratings. Some market participants have argued that it would be in both the dealers' and investors' interests if the ECP market developed along the lines of its counterpart in the United States, where at least one, and usually two, credit ratings are required.

International syndicated credits

In the international credits market, announcements in the second quarter declined from $41.1 billion to $25.2 billion. However, the first quarter figure was boosted by the exceptionally large ($13.6 billion) credit on behalf of Kohlberg Kravis Roberts (KKR) for the buyout of RJR Nabisco.

Announced eurocurrency syndicated credits
$ billions

	1987 Year	1988 Year	Q3	Q4	1989 Q1	Q2
Major OECD	61.4	72.8	21.3	19.0	31.2	16.7
Minor OECD	14.9	18.3	3.1	5.1	3.7	4.9
Developing countries	9.6	9.3	2.0	3.6	5.8	3.0
Eastern bloc	1.9	1.2	0.1	0.3	0.3	0.6
Other	0.8	0.2	—	—	—	—
Total	**88.7**	**101.7**	**26.5**	**28.1**	**41.1**	**25.2**

Merger and acquisition related financing remained strong, accounting for 36% of announcements, despite higher interest rates. In the United Kingdom, a particular feature was the growth of mezzanine finance (ie debt finance ranked higher than equity but lower than senior debt). Borrowers financing an acquisition were often able to obtain a larger quantity of funds by tapping the mezzanine market than by using a straight mix of senior debt and equity. Although the dollar was still the most active currency sector in the credits market, volumes grew in the sterling sector, where credits (a large proportion of which was for merger and acquisition related activity) increased from $2.7 billion to $5.8 billion. ECU credits proved attractive to Italian borrowers.

The major OECD countries accounted for 66% of total borrowing, minor OECD countries 19%. The bulk of loans were on behalf of non-financial corporate borrowers (75%), although banks were also active with facilities arranged on their behalf increasing from $1.5 billion to $2.6 billion. The volume of sovereign borrowing remained low (6%). Prime sovereigns can generally obtain cheaper funds through swap-related deals on the bond market or by access to the CP market. Creditworthiness constraints have prevented a revival in commercial lending to highly indebted countries, and during the second quarter credits for developing countries declined from $5.8 billion to $2.9 billion. Borrowing by Eastern bloc countries was again very subdued at only $0.6 billion.

The Basle capital adequacy rules have reportedly led to increased secondary market activity in the credits market. Banks are no longer keen to keep committed but undrawn facilities on their books, since the fees often do not cover the increased cost of capital. The result has been an increase in the volume of credit transfers, especially to smaller banks, which do not often get the chance to syndicate high-quality credits. The loan sales allow large banks to free their balance sheets and thus to arrange more credits and earn fee income. A large proportion of credits transferred are those involved in highly leveraged transactions. Banks take the fee income and then often sell a large proportion of the exposure to re-establish a balance in their risk/reward tradeoff.

International banking developments

Cross-border business of banks in the BIS reporting area recovered strongly in the first quarter of 1989 with business on both sides of the balance sheet increasing by $212 billion. This, largely seasonal, acceleration follows the markedly slower growth in the fourth quarter of 1988 (assets $36 billion; liabilities $65 billion).

Interbank business within the BIS reporting area accounted for most of the first quarter expansion but final lending was also strong. Following their usual strong seasonal pattern, banks in Japan built up their interbank business significantly, with business between them and other inside-area countries rising by $103 billion over the first quarter of 1989. Overall their lending accounted for $69 billion (33%) of the increase in total external lending by BIS-area banks. Yen-denominated lending by banks in Japan accelerated rapidly from $4 billion in the last quarter of 1988 to $18 billion in the first quarter of 1989, contributing to strong overall growth of yen lending. A notable feature of Japanese business was the faster growth of external business onshore compared with the offshore market. This may have been boosted by lending in yen to fund lending to Japanese residents by foreign branches of Japanese banks.

Business in Europe also grew strongly. Cross-border lending by banks in France expanded dramatically in the

Cross-border business of banks in the BIS-reporting area
$ billions; changes exclude estimated exchange rate effects

	1987 Year	1988 Year	Q2	Q3	Q4	1989 Q1	Out-standing at end-Mar. 1989
Liabilities vis-à-vis:							
BIS-reporting area	477.1	344.3	101.4	155.9	33.5	186.7	3,173.0
'Offshore' centres	125.9	94.4	25.1	48.6	5.8	10.3	817.5
Sub-total	603.0	438.8	126.5	204.6	39.3	197.0	3,990.6
Outside reporting area							
Developed countries	6.3	12.7	4.9	2.7	4.5	3.5	69.7
Eastern Europe	-0.7	4.4	0.9	1.0	2.0	0.2	33.9
Oil exporters	19.2	11.0	5.4	6.3	-1.1	2.4	178.4
Non-oil developing countries	24.0	11.3	3.5	0.7	3.7	3.9	237.7
of which, Latin America	*6.7*	*2.3*	*1.1*	*-2.0*	*-0.1*	*0.8*	*81.2*
Sub-total	48.8	39.5	14.7	10.8	9.2	10.0	519.7
Other(a)	34.5	32.5	2.8	1.0	16.0	4.7	216.9
Total	**686.2**	**510.7**	**144.0**	**216.3**	**64.5**	**211.8**	**4,727.2**
Assets vis-à-vis:							
BIS-reporting area	432.2	337.4	84.2	159.3	32.1	172.0	3001.5
'Offshore' centres	142.1	73.3	8.5	50.5	-3.9	35.6	779.6
Sub-total	574.3	410.8	92.7	209.8	28.2	207.6	3,781.1
Outside reporting area							
Developed countries	5.6	2.5	3.9	-3.2	2.5	0.9	128.5
Eastern Europe	2.3	8.0	1.3	0.3	3.5	2.9	86.7
Oil exporters	2.0	5.6	2.3	2.9	1.5	-2.9	124.4
Non-oil developing countries	1.8	-8.9	-6.2	-1.5	3.0	-0.9	367.8
of which, Latin America	*-3.9*	*-10.8*	*-3.8*	*-2.0*	*-2.5*	*-2.8*	*209.7*
Sub-total	11.7	7.2	1.3	-1.5	10.5	0.1	707.3
Unallocated and international institutions	11.2	1.9	0.8	4.4	-3.1	4.1	102.8
Total	**597.3**	**419.7**	**94.8**	**212.6**	**35.5**	**211.8**	**4,591.2**

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

first quarter of 1989, rising by $30 billion in sharp contrast to the modest $2 billion increase in the previous quarter. A key factor in this increase was the growing presence of Japanese banks in Paris where they are now ranked second behind French banks. Further capital liberalisation measures at the beginning of the year also appeared to have played a role. In contrast, German banks' external claims fell by $5 billion. In the United States, an increase of $20 billion in external lending by banks resulted in the United States being a net provider of $6 billion, in contrast to their position of net borrower of $14 billion in the fourth quarter of 1988.

Net international bank credit—which is an estimate of banks' lending to final users—was also very buoyant in the first quarter. Non-banks in the United Kingdom, the United States and Japan were notably active borrowers, either in foreign currency from banks at home or directly from banks overseas.

There was no overall growth in lending to countries outside the reporting area in the first quarter of 1989, while deposits from these countries rose by $10 billion. However, this disguises a further increase of $3 billion in cross-border claims on Eastern Europe and an equivalent fall in claims on the oil exporting countries. The rise in claims on Eastern Europe was entirely accounted for by growth in lending to the USSR. Recorded lending to the non-oil developing countries fell by $1 billion in the first quarter of 1989, following growth of £3 billion in the fourth quarter of 1988. Claims on Latin America continued to fall ($3 billion)—in particular lending to Argentina and Mexico contracted by $1 billion in each case; there was a further increase in lending to Asia of $2 billion.

The London market

In common with other countries in the BIS reporting area, there was a strong recovery in UK banks' external business *in the first quarter of 1989*. Cross-border claims increased by $25.0 billion (2.8%) in sharp contrast to the fall seen the previous quarter, and deposits rose by $40.9 billion (4.3%). Growth in interbank business accounted for much of this increase, but deposits from non-banks grew a further $9.6 billion following an increase of $5.7 billion in the previous quarter. Overall, UK banks were net takers of $15.9 billion in the first quarter of 1989.

The recovery in external business was almost entirely with the *BIS reporting area.* Following sluggish growth at the end of 1988 ($1.3 billion), lending to the BIS area rose by $31.1 billion (5.0%) in the first quarter of 1989, and the fall in deposits ($8.4 billion) in the fourth quarter of 1988 was more than offset by an increase of $34.5 billion (5.5%) this quarter.

Within the reporting area, banks in Japan were the largest net placers of funds with UK banks ($9.1 billion) during the first quarter of 1989; they placed $16.8 billion of deposits, but borrowed only $7.7 billion from UK banks. This increase in deposits is rather more than would normally be expected for seasonal reasons and is perhaps due to the marked difference between eurodollar and yen interest rates. Significant increases in deposits from Switzerland ($5.5 billion) and Germany ($5.5 billion) resulted in both these countries being major net placers of funds. The increase in German deposits may be due partly to the introduction on 1 January of a 10% withholding tax (later abolished) on interest and investment income.

UK banks' lending to the United States increased by $3.8 billion (2.9%) and deposits fell $0.9 billion (0.5%) making the United States the largest net taker of funds from UK banks within the reporting area ($4.7 billion); banks in the United States accounted for $3.1 billion of this net flow. With significant increases in UK banks' lending to France ($5.1 billion) and Italy ($3.1 billion), both were also major net takers of funds over the quarter. Again this business was concentrated in the interbank market.

There was a marked fall in lending to the *offshore centres* of $6.0 billion (5.3%) which was essentially due to reductions in claims on Singapore ($4.1 billion) and Hong Kong ($2.5 billion). This contraction may partly reflect liberalisation in the home markets which may be

Cross-border business of banks in the United Kingdom

$ billions; changes exclude estimated exchange rate effects

	1987	1988				1989	Out-standing at end-Mar.
	Year	Year	Q2	Q3	Q4	Q1	1989
Liabilities vis-à-vis:							
BIS-reporting area	56.9	41.2	16.3	23.0	-8.4	34.5	636.3
of which:							
United States	*14.1*	*7.7*	*5.5*	*3.0*	*0.6*	*-0.9*	*168.2*
Japan	*13.7*	*17.9*	*5.6*	*9.6*	*-6.1*	*16.8*	*112.0*
'Offshore' banking centres	4.3	-2.4	4.4	2.4	-4.8	4.5	117.3
Sub-total	61.2	38.8	20.7	25.4	-13.2	39.1	753.6
Outside reporting area							
Developed countries	3.0	5.7	2.1	3.4	-0.2	2.2	25.9
Eastern Europe	-0.1	1.1	0.1	0.3	1.4	-0.3	8.8
Oil exporters	0.2	6.8	3.9	2.4	1.7	2.1	54.5
Non-oil developing countries	8.8	-4.3	—	-2.0	-0.6	0.6	47.4
of which, Latin America	*3.0*	*-1.1*	—	*-1.5*	*0.7*	*-0.4*	*6.4*
Sub-total	11.9	9.4	6.1	4.1	2.3	4.6	136.6
Other(a)	21.6	16.0	-1.2	0.7	14.3	-2.7	83.2
Total	**94.7**	**64.3**	**25.5**	**30.3**	**3.5**	**40.9**	**973.4**
Assets(b) vis-à-vis:							
BIS-reporting area	80.6	46.5	14.8	27.0	1.3	31.1	638.9
of which:							
United States	*29.0*	*-10.8*	*4.9*	*0.1*	*-2.1*	*3.8*	*132.0*
Japan	*38.5*	*42.5*	*9.3*	*20.8*	*-0.2*	*9.5*	*215.1*
'Offshore' banking centres	4.0	-9.0	1.6	0.4	-7.5	-6.0	105.8
Sub-total	84.6	37.4	16.4	27.4	-6.2	25.1	744.7
Outside reporting area							
Developed countries	-1.5	-1.9	0.1	-0.6	0.1	-1.6	32.1
Eastern Europe	0.6	2.3	0.5	0.4	0.5	0.6	23.0
Oil exporters	-0.4	0.7	0.7	0.1	0.4	—	20.3
Non-oil developing countries	-2.4	-6.5	-1.9	-1.9	-1.4	-0.7	47.9
of which, Latin America	*-2.3*	*-3.9*	*-0.5*	*-1.6*	*-1.1*	*-0.4*	*30.3*
Sub-tota	-3.7	-5.5	-0.6	-2.1	-0.4	-1.7	123.3
Other(c)	6.0	3.9	0.6	3.3	1.3	1.6	14.7
Total	**87.0**	**35.8**	**16.4**	**28.6**	**-5.3**	**25.0**	**882.7**

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

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

(c) International organisations and unallocated.

encouranging some business back onshore, but offshore deposits increased by $4.5 billion (3.9%) making the offshore centres net placers of $10.5 billion with banks in the United Kingdom.

Elsewhere, the *oil exporting countries* increased their deposits by $2.1 billion (3.9%). Overall the *other developed countries* were net placers of $1.6 billion, half of which was accounted for by Australia. Within *Eastern Europe*, the USSR was the largest net taker, of $1.0 billion, owing to a further increase in lending ($0.6 billion) and a withdrawal of deposits of $0.4 billion. Deposits from the non-oil developing countries increased by $0.6 billion, reversing a fall in the fourth quarter of 1988.

Following a fall of half a percentage point in the last quarter of 1988, the share of Japanese incorporated banks and branches in external lending by all banks in the United Kingdom fell a further 0.9 of a percentage point in the first quarter of 1989 to 39.0%. British banks partially recovered the market share lost the previous quarter, increasing their share of lending by over half a percentage point to 15.4%. American banks continued to strengthen their position, by a further 0.3 of a percentage point to 13.6%. The 'other overseas' banks maintained the 31.9% share achieved the previous quarter.

There was a further shift away from sterling in favour of the deutschemark and the dollar during the first quarter of 1989. Deutschemark-denominated lending rose by $11.0 billion, increasing its share of total lending to 11.8%, and dollar lending rose a further $3.1 billion, to account for 58.1% of total outstanding lending at end-March 1989. Sterling's share of external lending fell almost one percentage point to 7.8% and lending denominated in Swiss francs fell to 3.8%, from 4.2%.

The international business of banks in the United Kingdom was subdued on both sides of the balance sheet *in the second quarter of 1989*. Following strong growth during the previous quarter, claims and liabilities fell back by $0.4 billion and $0.7 billion respectively with a particularly large drop in business with own offices overseas (claims – $11.5 billion, liabilities – $14.8 billion). Issues of CDs fell sharply ($6.5 billion) and foreign currency lending to UK banks was down by $4.1 billion. Other business continued to expand but rather more slowly than in the previous quarter. Cross-border sterling business was rather buoyant (claims $6.0 billion, liabilities £4.9 billion).

The activities of the Japanese banks accounted for the overall reduction in business. In particular, business with own offices fell by $15.6 billion on the claims side and $13.1 billion on the liabilities side, reflecting the seasonal unwinding of balances built up in the first quarter. British banks were rather subdued following a very active first quarter and the growth of the international business of the American banks also slowed. Other overseas banks were the most active sector with claims up by $7.8 billion and liabilities up by $6.3 billion.

Foreign exchange and gold markets

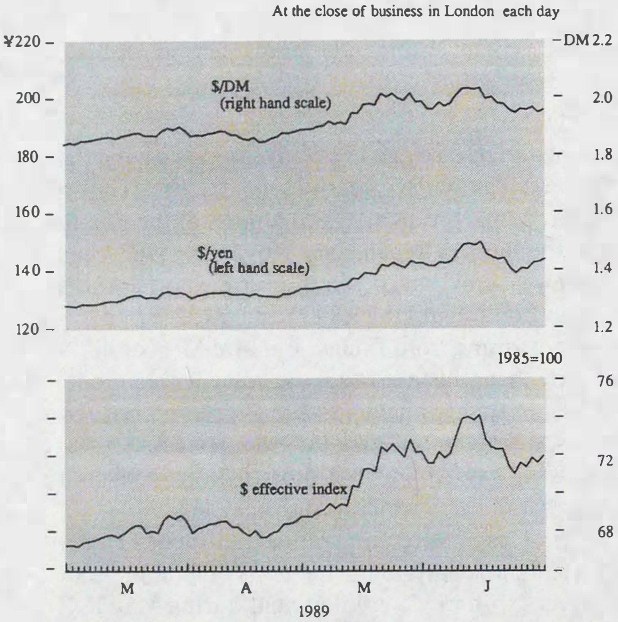
This section reviews the three months to end-June.

For the most part, underlying sentiment towards the dollar remained bullish and the US currency reached new recent highs following the release of encouraging US trade figures in mid-June. By that time, however, economic statistics were already providing tentative evidence that the US economy was slowing down, and the dollar fell sharply during the last two weeks of the quarter as expectations of an easing in US monetary policy became more widespread.

Following the release of a G7 communiqué saying that a rise in the dollar which undermined adjustment efforts would be counterproductive and reports of the first dollar sales by the Bank of Japan since November 1985, the US currency weakened sharply in the Far East on 3 April and opened in London at DM 1.8907 and ¥132.30. In the wake of a warning from French Finance Minister Beregovoy that a further rise in its value would hinder the correction of trade imbalances and trigger interest rate increases, the dollar fell back to DM 1.8665 and ¥130.65 the following day. Although it subsequently recovered a little against the yen, which was troubled by the continuing Cosmos-Recruit scandal, it dipped briefly to DM 1.8638 on 7 April following news of a more modest than forecast rise in US employment during March. It softened again following Herr Stoltenberg's replacement by Herr Weigel as German Finance Minister—which raised hopes of the cancellation of withholding tax (later confirmed)—and a ½% rise (to 4½%) in Swiss discount rate, and eased further on 14 April when a clutch of US economic data provided tentative evidence that the US economy was slowing. The US trade figures for February were only slightly worse than expected, but sluggish industrial production and capacity utilisation caused the dollar to give up earlier gains and, when figures showing only a small rise in US consumer prices and a fall in US housing starts were released on 18 April, it dipped sharply to DM 1.8500 and ¥131.30. An unexpected ½% rise in German interest rates caused the US currency to fall further and it touched lows for the period of DM 1.8425 and ¥130.97 on 20 and 21 April. However, stronger-than-expected US GNP data published on 26 April sparked a recovery and the dollar touched DM 1.8835 and ¥133.02 on 28 April in the wake of a statement from Bundesbank Council member Koehler that it was the US currency's volatility, not its level, which was troublesome. Receding expectations of an early rise in Japanese interest rates (following a modest increase in consumer prices there) generated further demand for the US currency.

As the dollar showed signs of recovering from its April lows, Japanese financial institutions, including life assurance companies and pension funds, re-emerged as heavy buyers of dollars and a temporary shift in their behaviour away from hedging their investments by selling forward dollars added considerably to the upward pressure on the US currency. Thus, although US employment data for April were weaker than forecast, the effect on the US currency was short-lived and the dollar rose steadily, closing at DM 1.9725 and ¥139.32 on 17 May following the release of improved US trade figures, and it drew further strength from the absence of

Dollar exchange rates



any tightening of monetary policy in Germany and Japan. Reports that the Bundesbank had not participated in recent bouts of concerted intervention also boosted the dollar and, following press reports that the US government was prepared to acquiesce in a higher dollar, it advanced to DM 2.0285 and ¥143.05 on 23 May before falling back on suggestions that the US government was considering reducing US interest rates in order to stem its rise.

Conditions subsequently became very volatile. The dollar initially weakened sharply (to DM 1.9550 and ¥139.82 on 26 May) in the wake of a downward revision to US GNP in the first quarter and the announcement that the Swiss were moving to a flexible Lombard rate, only to rebound to DM 2.0240 and ¥144.00 on 30 May despite reports of concerted intervention. A 0.75% increase to 3.25% in Japanese discount rate (the first such rise for nine years) was shrugged off, but news that German interest rates were to remain unchanged subsequently caused the dollar to soften and, in the wake of weaker-than-anticipated US employment data for June and the announcement by a provincial bank of a ½% cut in prime rate, it fell sharply to DM 1.9350 and ¥140.15 on 5 June. Although major US banks later announced a similar reduction (to 11%) in prime rates, the impact of this was more than offset by the dollar's safe-haven attributes as developments in China and, to a lesser degree, the uncertainty in Iran provoked flows (particularly out of yen) into the US currency. Although persistent reports of further intervention by the Federal Reserve and the Bank of Japan briefly caused it to ease, the dollar was carried up to new recent highs of DM 2.0470 and ¥151.75 on 15 June following news of a contraction in the US trade deficit in April. However, it suffered a steep technically-based fall in New York that evening and drifted lower during the ensuing week following reports of concerted intervention and the publication of US durable goods orders data which seemed to confirm a slowdown in the US economy. After lows of DM 1.9355 and ¥138.30 on 23 June, a firmer tone was evident, particularly against the yen, which was depressed by political uncertainties. However, by the end of the quarter, the dollar had slipped back against most European currencies following increases in interest rates there. It closed on 30 June at DM 1.9542 (up 2.9%), ¥144.02 (up 8.5%) and Sw.Fc. 1.6785 (up 0.9%); in effective terms, however, it rose by 4.5% to 71.9 (1985 = 100).

EMS

The strength of the dollar helped ease the tensions which had been evident within the EMS before Easter and, with the Danish krone benefiting a little from a cut in financial institutions' borrowing ceiling with the central bank, the system settled down to enjoy a relatively comfortable period.

The deutschemark strengthened against all ERM currencies following an unexpected ½% increase in German interest rates on 20 April, but interest rates in Denmark, the Netherlands and Belgium rose in line with those of the Bundesbank and no currency came under pressure. Towards the end of April, the French franc gained ground in the wake of news of a narrowing in the French trade deficit and the Irish punt also strengthened after the Central Bank of Ireland raised its key short-term facility rate by 1% to 9%.

During May and June, the Dutch guilder challenged the deutschemark for the highest position in the system and the Italian lira, showing little reaction to Mr Ciriaco de Mita's resignation as Prime Minister, moved above the French franc. However, the width of the narrow band remained relatively steady and it ended the quarter 2% wide between the deutschemark and the Danish krone.

At the beginning of June, Spanish Economy Minister Carlos Solchaga set 1 July 1990 as a deadline for the peseta's entry into the Exchange Rate Mechanism of the EMS. It came as something of a surprise to the market when, on 16 June, it was announced that the Spanish peseta would join the ERM on 19 June (at a central rate of 65 to the DM and with a 6% margin). The protection offered by the system made Spanish interest rates very attractive and a sharp appreciation of the peseta ensued. There were reports of intervention by the Bank of Spain and this, together with a fall in short-term money-market rates and in three-month euro-peseta rates, succeeded in stemming the upward pressure. In the last week of the quarter, however, an increase in short-term money-market rates underpinned a renewed rise in the peseta.

Other currencies

Having opened on 3 April at ¥69.97 (= 1 DM), the yen remained subdued by political uncertainties and fell back to ¥71.09 on 21 April in the wake of Herr Stoltenberg's replacement by Herr Weigel as German Finance Minister and the increase in official German interest rates. Sentiment towards the Japanese currency subsequently improved a little amid suggestions that the central bank might increase its discount rate in response to continuing uncertainty over the Cosmos-Recruit share scandal; it touched ¥70.41 on 25 April when Prime Minister Takeshita's resignation raised hopes that the worst of the scandal had passed. However, it suffered more than the deutschemark from the subsequent period of dollar strength partly because of fears that the unrest in China would adversely affect imports from Japan. In spite of a ¾% increase in Japanese discount rate on 30 May, investors switched funds into the deutschemark where strong economic growth had increased the possibility that Germany might have to push interest rates higher too. Moreover, the yen continued to suffer from investor fears about political scandal in Japan, falling to ¥74.03 on 15 June. However, the dollar's subsequent weakness, helped by reports of persistent intervention, benefited the Japanese currency more than others and it recovered to ¥71.66 on 23 June before falling back again in the wake of European interest rate increases and speculation that the new Prime Minister, Uno, might be forced to resign.

Elsewhere, the Swiss franc initially weakened on unfavourable interest differentials. A ½% increase in Swiss discount rate on 13 April briefly boosted the franc, but it fell back again until the introduction, on 25 May, of a floating Lombard rate (effectively a 1½% increase) provided the Swiss franc with stability; it rose from Sw.Fc. 0.8930 (= 1 DM) on 22 May to Sw.Fc. 0.8585 on 1 June). A 1% rise in Swiss discount rate (against ½% increases in rates in other European countries) with effect from 30 June ensured that it remained on a firmer tack.

Gold

Having been fixed on the morning of 3 April at $385.30, gold firmed on the back of higher oil prices, reaching a fixing high for the period of $390.25 on 13 April. However, it dipped sharply on 15 April when US statistics failed to suggest rising inflationary pressures and eased further in the ensuing week (to $382.90 on 19 April), reflecting a fall in platinum and palladium prices. After a brief technical rally, a further sharp fall was triggered by weak US leading indicators data on 28 April, a fall which gathered pace as the crucial support price of $380 was broken. Gold subsequently suffered from the burgeoning strength of the dollar and from reduced concerns about inflation following an unexpectedly modest rise in US producer prices in April. Options selling and lower silver prices contributed to the period of weakness which saw gold dip to $359.25 on 22 May.

During the remainder of the period, gold was heavily influenced by the dollar's movements. It advanced to $367.20 on 26 May, but moved back towards its lows as the US currency recovered and, although developments in China then gave gold a further boost, it fell sharply at the beginning of June when the dollar surged in the wake of US producer prices data. Gold was fixed at a low for the period of $358.50 (its lowest fixing since August 1986) on the morning of 12 June; reports of Chinese sales contributed to the decline. However, it subsequently embarked on a cautious recovery which gained momentum in active trading as the dollar began to fall away. After fixing at $376.30 on 29 June, heavy selling of silver caused a brief setback and gold ended the quarter at $373.00 (down 2.7%).