

ECU banking and bond market activity

Official European currency units (ECUs) were introduced over eleven years ago to serve as a reserve asset and means of settlement for central banks in the European Community. In that time the ECU has rapidly developed in private markets to become a major currency in trade and finance. This note updates an earlier review of ECU financial activity⁽¹⁾ and looks at developments in ECU banking business within Europe and more particularly London during 1989 and the first quarter of 1990. The note also summarises the performance of ECU bond markets in the same period, focusing largely on developments in the first quarter of 1990.

International ECU-denominated assets of banks in the BIS reporting area rose at a rapid rate from ECU 7 billion at the end of 1982, the earliest date for which figures are available, to ECU 114 billion at the end of March 1989.⁽²⁾ In the year to end-March 1990, ECU banking activity continued to expand alongside the introduction of ECU-denominated interest rate futures on the LIFFE and the successful issues of ECU Treasury bills by the UK and Italian governments.

About 84% of ECU banking activity within the BIS reporting area at the end of March 1990 was concentrated within five European financial centres: France, Luxembourg, Belgium, Italy and the United Kingdom. However, banking activity in the ECU is gradually becoming more widespread within the BIS reporting area. For instance, banks in Japan have been accumulating ECU assets rapidly from a low level of ECU 1.0 billion at the end of 1987 to ECU 4.4 billion at end-March 1990. Similarly, ECU-denominated lending by banks in West Germany has picked up noticeably since the end of 1987, although the West German and Japanese shares of total ECU business within the BIS reporting area remain relatively low.

Growth in ECU liabilities of banks in the BIS reporting area has been quicker than asset growth since the end of 1988 though, in absolute terms, assets have exceeded liabilities by ECU 12 billion throughout 1989. However, figures for the first quarter of 1990 show a fall in the net asset position of banks in the BIS reporting area from ECU 12.1 billion at end-December 1988 to ECU 6.6 billion at end-March 1990. Banks in France recorded the largest net asset position of ECU 1.5 billion at end-March 1990, followed by banks in Belgium and Luxembourg with net assets of ECU 1.4 billion and ECU 0.7 billion respectively.

The ECU banking market within the BIS reporting area is predominantly interbank, which accounts for over 76% of all lending denominated in ECU, and some 89% of ECU deposits taken. Whereas the ECU interbank market continued buoyant throughout 1989 and the first quarter of

Table A
ECU lending by BIS-area banks

ECU billions, amounts outstanding at end-periods: percentages in italics

	1988	1989			1990	
	Dec.	Mar.	June	Sept.	Dec.	Mar.
Total international assets	100.9	114.0	121.5	121.8	125.1	135.9
of which:						
Banks	74.4	85.6	91.9	91.3	93.6	103.5
Non-banks	26.5	28.4	29.7	30.5	31.5	32.4
of which:						
United Kingdom	28	28	28	29	29	31
France	24	24	22	20	20	18
Belgium	14	14	12	12	13	12
Italy	12	13	16	15	15	14
Luxembourg	9	8	9	9	9	9

Source: BIS.

1990, the growth of ECU business with non-banks was relatively slow. Lending in ECUs to non-banks by banks in the BIS reporting area increased from ECU 27 billion at end-December 1988 to ECU 32 billion at end-March 1990. Banks in Belgium, Luxembourg and the United Kingdom accounted for nearly 70% of total ECU cross-border lending to non-banks. The largest lenders in ECUs to domestic non-bank residents were banks in Italy, France and the United Kingdom.

The London market

By the end of December 1988, London had replaced Paris to become the largest centre for ECU banking business in Europe. Outstanding ECU assets of banks in the United Kingdom rose from ECU 28 billion at end-December 1988 to ECU 42 billion at end-March 1990 (see Table B), while ECU assets of banks in France have remained steady at ECU 29 billion over the same period. At the end of March 1990, 31% of banks' ECU claims within the BIS reporting area were booked in London. ECU asset accumulation by banks in the United Kingdom was well matched by ECU deposit taking, which rose by 67% from ECU 25 billion at the end of 1988 to ECU 41 billion at end-March 1990.

In common with other major ECU financial centres in Europe, ECU banking activity in London was primarily interbank with ECU-denominated lending to non-bank local

(1) See 'ECU financial activity' in the November 1988 *Bulletin*, pages 509-16.

(2) At end-March 1990, 1 ECU = £0.7328 and \$1.2059.

Table B
ECU business by banks in the United Kingdom

ECU billions, amounts outstanding at end-periods

	1988		1989			1990
	Dec.	Mar.	June	Sept.	Dec.	Mar.
Total liabilities	24.6	28.7	30.4	31.7	33.1	41.2
of which:						
UK banks	6.6	8.1	8.6	8.7	7.4	9.1
Other UK residents	1.1	1.0	1.0	0.9	1.2	1.2
Overseas residents	15.5	17.3	18.5	19.9	22.3	25.8
Forward sales	25.4	32.2	32.7	34.0	38.7	55.8
Total assets	27.8	31.9	34.4	35.6	36.2	41.9
of which:						
UK banks	4.7	6.8	6.7	6.8	6.2	8.5
Other UK residents	1.3	1.2	1.4	1.4	2.2	2.7
Overseas residents	17.0	19.5	21.0	21.3	21.3	23.3
Forward purchases	26.6	30.1	35.4	38.0	38.8	71.0

Source: Bank of England.

residents accounting for just 6% of total lending in ECUs, and ECU deposits from locally resident non-banks making up 3% of total ECU deposits at end-March 1990.

A significant feature of ECU banking developments during 1989 and, in particular, the first quarter of 1990 was the rapid increase in ECU forward market activity as symbolised by a more than doubling of ECU forward positions from December 1988 to March 1990. Forward purchases rose from ECU 27 billion at end-December 1988 to ECU 71 billion at end-March 1990, with a sharp rise in the first quarter of 1990. In the same period, forward sales increased by 120% to ECU 56 billion. Buoyant activity in ECU forward markets reflects in part an increase in the number of counterparties but also indicates a growing cash market in ECU financial instruments during 1989 and 1990.

The London branches and subsidiaries of Japanese and Italian banks made up 60% of total international ECU lending by banks in the United Kingdom at the end of March 1990. The share of British owned banks in the total fell from 21% at end-March 1988 to under 16% at end-March 1990. For banks in the United Kingdom as a whole, the ECU's share of total outstanding cross-border lending rose gradually from 2.7% at end-March 1989 to 3.2% at end-March 1990, and it is now the sixth largest currency denomination for external lending by banks in the United Kingdom.

ECU bond market

The value of outstanding ECU-denominated international bonds is only 40% of the size of the ECU credit market: however, the ECU is already the fifth largest currency sector,

Table C
International bond issues by currency of denomination

Percentages

	1987	1988	1989	1990 H1
US dollars	35.8	36.7	49.6	31.6
Swiss francs	13.6	11.8	7.4	10.0
Sterling	8.5	10.8	7.8	10.8
Deutschemarks	8.5	10.4	6.2	9.5
Yen	14.1	9.1	9.0	11.5
Canadian dollars	3.4	5.8	4.8	2.3
ECU	4.2	4.9	4.7	9.7

Source: Bank of England ICMS database.

by issuance, in the international bond markets. The ECU bond market has recently seen a sharp upturn in primary activity. Outstanding ECU issues have risen from ECU 26.0 billion at end-1986 to ECU 47.6 billion at the end of the first quarter of 1990.⁽¹⁾ Issues of international ECU bonds rose sharply in the first quarter, accounting for over 9% of all international issues, compared with around 4.5% in the years 1987 to 1989 (see Table C). London is the main international centre for the primary issue of ECU bonds, accommodating most of the major international ECU book-running houses.

Several factors have contributed to the increase in ECU borrowing so far this year. The opening of a swap window in the first half of 1990 ensured continued opportunistic borrowing. Moreover, while there has been substantial investor interest in the ECU for some time now, the volatility of the deutschemark⁽²⁾ and German interest rates has increased the ECU's appeal still further.

Analysis of this year's issues reveals that sovereign and supranational issues accounted for roughly 52% of new issues by value. Sovereign borrowers have always been prominent in the sector. The European Investment Bank is the largest issuer of ECU bonds with cumulative issues of ECU 5.6 billion to date, followed by the European Community/European Coal and Steel Community, who have issued ECU 3.5 billion to date. Large issues by sovereign and supranational borrowers have attracted institutional investors to the ECU bond markets by increasing potential deal sizes and deepening liquidity.

Table D
Total international ECU issues: by country and sector of borrower

ECU millions, as at end-June 1990

	Banks	Government sector	Financial	Supra-national institutions	Other private sector	Total
France	2,147	2,893	1,710	—	4,170	10,920
Italy	1,340	2,928	20	—	1,166	5,454
United States	486	—	375	—	4,517	5,378
Japan	1,602	—	240	—	2,604	4,446
Belgium	689	800	550	—	153	2,192
Denmark	367	1,585	110	—	105	2,167
Germany	1,045	—	—	—	125	1,170
United Kingdom	140	—	440	—	69	1,275
Unallocated	—	—	—	13,566	75	13,641
Other	3,656	4,173	2,374	—	2,599	12,801
Total	11,472	12,379	5,818	13,566	16,208	59,443

Source: Bank of England ICMS Database.

Recent sovereign issues, most notably the Republic of Italy's two ECU 1 billion issues, have also been important in providing the sector with high quality, highly liquid benchmarks, from which other issues can be priced. The first Italian issue has already been used as the basis for an over-the-counter ECU interest rate warrant, and is deliverable (as are several similar issues) for settlement of a recently launched OTC ECU futures contract. In addition the MATIF has announced a new ECU OAT (French government bonds) futures contract. The new exchange traded contract is to be launched on 18 October.

(1) Source: Bank for International Settlements.

(2) The deutschemark component of the ECU is approximately 30% of the ECU's total value.