Financial market developments

Prices in many financial markets advanced strongly during the first quarter, reflecting increased confidence following the ending of the conflict in the Gulf, and an easing in interest rates in several countries, including in the United States and the United Kingdom (Table A). By the end of February (when hostilities ceased) equity prices in major markets were about 15% higher than before the mid-January deadline for Iraq's withdrawal from Kuwait. Bond markets also advanced at the same time, with the strongest gains in France. The gains in bond and equity markets were generally trimmed back slightly in March but most markets still ended the first quarter of 1991 significantly higher than they had begun it. In the foreign exchange market, the dollar was weak for much of the quarter (reaching an historic low against the deutschemark on 12 February) but then began a strong recovery, ending March at 12% above its trough in trade-weighted terms.

There were a number of developments during the first quarter which may be pointers to future financial market trends: the increase in issues in capital markets, steps to improve the profitability and capital ratios of banks, and a return to the markets by some LDCs.

Table A
International financial markets: key indicators

	1990			1991
	1 Aug: pre-invasion	28 Sept.	31 Dec.	28 Mar.
United Kingdom				
Equity market: FT-SE 100	2,339.0	1,990.2	2,143.5	2,456.5
10-year government bond yield %	11.7	12.1	11.0	10.1
3-month Treasury bill yield %	14.8	14.8	13.8	11.6
United States				
Equity market: S&P 500	355.3	306.1	330.2	375.2(a)
10-year government bond yield %	8.3	8.8	8.1	8.0(a)
3-month Treasury bill yield %	7.7	7.3	6.6	5.9(a)
Canada				
Equity market: TSE Composite	3,569.0	3,159.0	3,256.8	3,495.7
10-year government bond yield %	10.5	11.2	10.3	9.5
3-month Treasury bill yield %	13.2	12.5	11.4	9.7
Japan				
Equity market: Nikkei 225	30,838.0	20,983.5	23,848.7 (b)	26,292.0(c)
10-year government bond yield %	7.2	8.2	6.6 (b)	6.6(c)
3-month Treasury bill yield %	7.6	8.3	7.6 (b)	7.9(c)
Germany				
Equity market: DAX	1,892.9	1,334.9	1,398.2 (b)	1,522.8
10-year government bond yield %	8.5	9.0	9.0 (b)	8.5
3-month interbank interest rate %	8.1	8.6	9.3 (b)	9.1
France				
Equity market: CAC General	525.9	415.3	413.0 (b)	479.8
10-year government bond yield (OAT) %	9.5	10.6	10.0 (b)	9.1
3-month Treasury bill (BTF) discount rate %	9.4	9.9	9.61 (b)	9.1
Italy				
Equity market: BCI	721.9	557.6	519.4	581.2
7-year government bond yield %	14.0	14.6	14.5	13.7
3-month interbank interest rate %	11.8	10.7	13.8	11.9

(a) 28 March.
(b) 28 December.
(c) 29 March.

It is difficult to judge how much the increase in capital issues in the first quarter owes to the strong market conditions rather than being attributable to the beginnings of a trend for some borrowers to rely less on banks for finance (for example, in the United Kingdom, sterling commercial paper outstanding rose quite fast in the first quarter while bank lending continued to slow). Such a trend would be encouraged by the rise in the margins charged by banks, which began last year and continued in the first quarter of 1991. Any switch towards raising finance in the capital markets would perhaps be expected to be concentrated on higher-rated borrowers, with a possible consequence being tiering—those without access to capital markets would be expected to draw their debt finance from the banks.

The extent of the rally in equity markets in the first quarter differed between countries, with the rise being muted in Germany and Canada. By the end of March, the equity markets in the United States and the United Kingdom, alone among the major economies, had risen above the levels before Iraq's invasion of Kuwait. These differences in stock market performance between end-July and end-March in part reflected different stages in the economic cycle in different countries. Both the US and UK economies were moving into recession in mid-1990; but by early this year the markets were anticipating recovery, re-inforced in each case by cuts in short-term interest rates. By contrast, activity was relatively strong in the other major economies last summer, but more recently has been showing signs of slowing (see pages 181-2). The problems of unification in Germany muted the rise in stock prices there.

Stronger financial markets have helped ease pressures on the capital ratios of banks in two ways. First, they have provided favourable conditions in which to issue equity and subordinated debt: US and Japanese banks took advantage of this during the first quarter. Second, higher Japanese equity prices raised the value of Japanese banks' equity holdings and therefore lifted their tier two capital; major Japanese banks are believed to have met the BIS interim capital adequacy standards (of 7.25%) at end-March.

The prospective emergence from recession in the United States, together with the recent cuts in US interest rates, should enhance bank debtors' ability to service loans, and therefore help to improve the credit standing of the banks. Consistent with this, the stock market prices of US banks, having fallen sharply in the first ten months of 1990 (by 35% relative to the market) outperformed the market indices during the winter rally by 12%, and the spreads of bank debt over US Treasuries narrowed. Nevertheless, significant pressures on Japanese and US bank balance sheets still remain, and during the first quarter there was continued evidence of rationalisation, particularly among US banks, as well as a general restriction on asset growth (see the note on page 214).

The pressures on banks' balance sheets and the concern of many banks to rebuild profitability, particularly against a background of increased loan losses, encouraged the banks to widen margins to their borrowers, by perhaps 10 to 15 basis points or so for top-rated borrowers in the first quarter (the rise was more in some cases, for example for top-quality Japanese borrowers), taking the increase in margins since autumn last year to perhaps 20 to 25 basis points. This has continued to encourage some borrowers of sufficient credit standing to turn to alternative means of finance, for example issuing securities. The widening in bank margins, and a more selective approach to credit approval, should help to rebuild banking profitability and capital ratios and therefore, over time, better equip the banks to meet future demands for finance.

In the bond markets, spreads between corporate bonds and US Treasuries narrowed during the first quarter, reversing most of the sharp widening seen towards the end of last year, reflecting a more optimistic assessment by the markets of future corporate prospects, as well as a search for higher yields as those on US Treasuries fell.

There have been further signs of improvement in the external positions of certain Latin American borrowers, although borrowing by these countries did not pick up in the first quarter. The secondary market price of Mexican, Venezuelan and Chilean debt rose significantly; Mexico raised $1.3 billion in the bond market (including the first Eurobond issue by the Mexican government for ten years) and $3.1 billion in syndicated debt. Chile's return to the Eurobond market, announced last December, was substantiated by its $200 million floating-rate issue, to be followed by a second tranche next year. These developments may mark the start of a return to more normal market relations for some LDCs.

Poland has recently benefited from debt forgiveness, which will have improved its ability to meet other commitments. As yet there is little sign that the potential demand for funds in Eastern Europe as a whole is being translated into actual flows. Indeed, lending by BIS-area banks to Eastern Europe has declined in recent quarters (see the note on page 214), as banks have become more cautious, uncertainty about future economic prospects has increased and the coverage of state guarantees has narrowed. The pressures on real interest rates world-wide which the increased demand for funds in Eastern Europe (and the Middle East) could bring about has failed to materialise much as yet because little of the notional demand for funds has been reflected in flows.

New debt issues and turnover in the international markets

New funds raised through the international markets increased quite sharply in the first three months of 1991 to $147.5 billion, the highest quarterly total recorded (Table B). The increase was more than accounted for by a rise of $30 billion in international bond issues, concentrated in the straight fixed-rate sector. The volume of issues was particularly high in February, when bond yields were falling

Table B
Total financing activity:[(a)] international markets by sector
$ billions, by announcement date

	1989	1990				1991
	Year	Year	Q2	Q3	Q4	Q1
Fixed-rate bonds						
Straights	150.0	172.5	42.9	36.5	50.0	80.8
Equity related	85.1	33.1	2.4	12.9	6.5	7.4
of which:						
Warrants	*69.6*	*22.6*	*0.7*	*9.8*	*4.8*	*5.5*
Convertibles	*15.6*	*10.5*	*1.7*	*3.1*	*1.7*	*1.8*
Bonds with non-equity warrants (currency, gold, debt)	0.5	0.1	0.1	—	—	0.1
Total	**235.6**	**205.7**	**45.4**	**49.4**	**56.5**	**88.3**
Floating-rate notes	27.1	57.6	10.9	29.6	7.3	5.9
Euronote facilities	72.5	72.9	17.0	12.6	21.6	15.1
Syndicated credits	151.8	165.2	38.3	43.6	43.5	38.2
Total	**487.0**	**501.4**	**111.6**	**135.2**	**128.9**	**147.5**

(a) Maturities of one year and over. The table includes euro and foreign issues and publicised placements. Issues which repackage existing bond issues are not included. Figures may not add to totals because of rounding.

as confidence improved in response to news from the Gulf. The volume of new issues declined in March as investors absorbed the large quantity of recent new issues and re-appraised the economic outlook. Bond financing activity by corporations strengthened during the first quarter, and in the United States even the high-yield bond market showed signs of recovery. But it was official borrowers who dominated the fixed-rate bond sector in the first quarter.

The increased volume of issues was accompanied by a marked shift in their currency composition (see Table C). Though the volume of euroyen issues continued around the level of the strong fourth quarter (to an extent reflecting Japanese corporate borrowing to refinance other sources of borrowing, including equity-related borrowing) the yen's share in new issues almost halved in the first quarter, with issues in Ecu and Canadian dollars filling the gap. Issues in

Table C
Currency composition of fixed-rate bond issues
Percentages of total issues announced

	1990			1991
Currency denomination	Year	Q3	Q4	Q1
US dollars	35	43	28	30
Swiss francs	12	12	11	7
Yen	15	14	19	11
Deutschemarks	5	5	4	3
Sterling	6	3	7	7
Australian dollars	4	5	4	2
Canadian dollars	3	4	4	9
Ecu	9	4	9	19
French francs	4	4	5	4
Other	7	6	9	8

International banking developments

Against the uncertain background of the Gulf crisis and weakening economic activity in many countries, the growth of the cross-border banking business in the BIS reporting area slowed markedly during the fourth quarter of 1990, rising by some 2% (assets $165.6 billion, liabilities $138.2 billion). In the interbank market Japanese banks, which had carried out sizable business in the third quarter, became less active. About two thirds of the $118 billion expansion in cross-border interbank claims was with related banking offices.

During the fourth quarter, outside-area countries were very large net suppliers of new funds to the international banking sector; new deposits, which had amounted to $18.8 billion in the third quarter, nearly doubled to a record $36.4 billion. A major factor behind this pronounced increase was the surge in oil prices during the second half of 1990. OPEC countries in the Middle East, which had drawn down their deposits in the immediate aftermath of the invasion of Kuwait by Iraq, built up their balances with the reporting banks by a record $21.5 billion; the largest additions were recorded for Saudi Arabia ($11.8 billion) and the United Arab Emirates ($6.3 billion).

For the year as a whole, gross international bank credit grew by 9%, six percentage points less than in 1989. There was a marked deceleration in interbank transactions and a further contraction in banks' outstanding claims on the rest of the world. By contrast, direct lending to the non-bank sector within the reporting area continued to expand at a rapid pace (21%).

Cross-border business of banks in the United Kingdom
$ billions: changes exclude estimated exchange rate effects

	1989		1990				Outstanding at-end Dec.
	Year	Q4	Q1	Q2	Q3	Q4	1990
Liabilities vis-à-vis:							
BIS industrial area	58.7	9.0	16.3	-5.3	27.8	35.0	801.6
of which:							
United states	*-15.7*	*1.5*	*-16.2*	*1.2*	*8.7*	*10.2*	*160.0*
Japan	*18.0*	*-3.7*	*4.8*	*-9.7*	*2.4*	*-4.3*	*109.1*
'Offshore' banking centres	6.6	-0.8	0.6	-4.1	1.3	0.8	126.1
Sub-total	65.3	8.2	16.9	-9.4	29.1	35.8	927.7
Outside reporting area							
Developed countries	5.4	1.1	1.0	-0.2	2.2	-1.1	36.5
Eastern Europe	0.4	—	-1.0	-0.9	0.6	0.4	6.0
Oil exporters	3.5	-1.7	1.0	—	5.0	5.9	71.1
Non-oil developing countries	2.3	0.8	0.5	2.6	2.3	1.1	59.6
of which, Latin America	*0.6*	*0.3*	—	*0.9*	*0.8*	*0.5*	*8.2*
Sub-total	12.6	0.2	1.5	1.5	10.0	6.3	173.2
Other (a)	3.7	2.1	2.0	5.8	2.8	-6.1	100.4
Total (d)	**81.6**	**10.5**	**20.4**	**-2.1**	**41.9**	**36.0**	**1,201.3**
Assets (b) vis-à-vis:							
BIS industrial area	50.0	11.2	23.4	-2.3	43.3	26.4	805.1
of which:							
United States	*0.9*	*-0.3*	*-0.8*	*3.7*	*5.2*	*10.6*	*150.8*
Japan	*9.9*	*-1.6*	*0.6*	*-9.7*	*13.1*	*-2.5*	*223.0*
'Offshore' banking centres	8.1	1.7	0.4	4.9	2.8	-1.8	130.7
Sub-total	58.1	12.9	23.8	2.6	48.1	24.6	935.8
Outside reporting area							
Developed countries	-2.0	0.7	-0.4	1.4	0.1	-0.9	35.4
Eastern Europe	1.9	0.3	-0.9	-1.5	-1.3	-0.9	17.0
Oil exporters	-1.4	-0.5	-0.2	-0.7	-0.6	-0.2	18.6
Non-oil developing countries	-3.4	-2.2	-2.8	-2.0	0.6	1.1	43.7
of which, Latin America	*-2.6*	*-1.3*	*-3.1*	*-2.5*	*-0.1*	*0.6*	*23.4*
Sub-total	-4.9	-1.7	-4.3	-2.7	-0.9	-0.9	114.7
Other (c)	4.1	3.1	1.0	5.0	4.3	-8.2	18.5
Total (d)	**57.3**	**14.3**	**20.5**	**4.8**	**49.3**	**15.5**	**1,069.0**

(a) International organisations, unallocated and international issues of securities.
(b) Including securitised lending
(c) International organisations and unallocated
(d) Includes business unidentified by sector.

The London market

The pace of cross-border lending of banks in the United Kingdom slowed considerably in the final quarter of 1990, after rising rapidly in the previous three months (see the table). Most of the slowdown was accounted for by lending to the BIS industrial area, in particular to Japan. Lending to Japan fell in the fourth quarter, and scarcely increased during 1990 as a whole, possibly reflecting pressures on Japanese banks to slow the growth in their balance sheets and, perhaps, the development of the Japanese offshore centre which may have changed the pattern of flows between London and Japan. Lending to the US rose twice as quickly in the fourth quarter as in the third, with banks in the United States borrowing $11.5 billion from those in London (the highest total since the third quarter of 1987), while loans to Italy and Belgium totalled $5.6 billion and $3.0 billion respectively. Lending outside the BIS area continued to decline, with lending to Eastern Europe falling for the fourth successive quarter, this time by $0.9 billion (of which the USSR accounted for $0.4 billion). During 1990 as a whole lending to Eastern Europe fell by $4.6 billion (or 21% of the amount outstanding at the beginning of the year) as banks adopted a cautious approach to the difficult economic conditions in Eastern Europe. Lending to non-oil developing countries increased slightly in the fourth quarter, with the largest increase in lending to Latin America since the final quarter of 1986. 'Other' lending fell by $8.2 billion in the fourth quarter; this was mirrored by a fall in 'other' liabilities also.

The total cross-border liabilities of banks in the United Kingdom rose only slightly more slowly in the fourth quarter than in the third, but within the total liabilities to BIS-area banks rose more quickly, with increased borrowing from Belgium ($13.2 billion) and the United States ($10.2 billion, evenly split between banks and non-banks) being the main contributors. External liabilities to Japan fell by $4.3 billion in the fourth quarter (of which $3.9 billion were interbank deposits), giving a fall of almost $7 billion for 1990 as a whole. Liabilities to oil exporting countries rose by $5.9 billion (about 9%) in the last three months of 1990, with a rise in deposits from Saudi Arabia ($4.6 billion) being the main component for the second successive quarter.

Japanese incorporated banks maintained their share of external lending at 34.3% in the fourth quarter, while British-owned banks saw their share fall by 0.4 percentage points to 13.4%. American owned banks' share rose by 0.1 of a percentage point to 13.9%. The 'other overseas banks' continued to increase their share, by 0.3 percentage points to 38.5%.

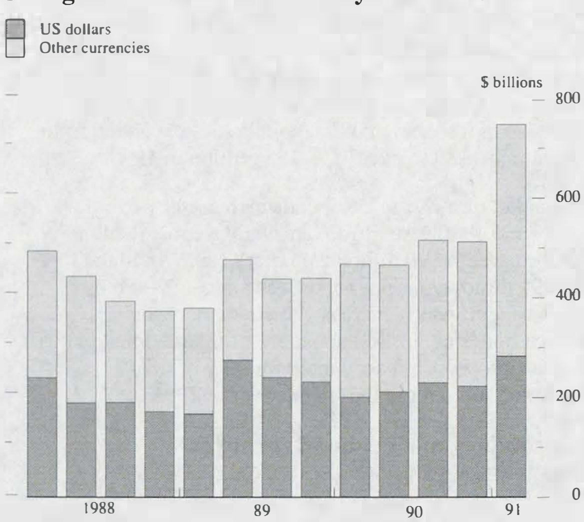
In the first quarter of 1991 the external business of banks in the United Kingdom was very muted, with claims and liabilities rising by just $1.9 billion and $6.3 billion, respectively. The international business of British-owned and American banks grew marginally during the first quarter, with the main increase in lending to UK banks and UK non-banks. But the main features were strong growth recorded for the 'other overseas' banks (assets +$27.6 billion, liabilities +$29.9 billion) and a sharp decline in Japanese banks' business (assets -$37.3 billion, liabilities -$35.4 billion). This sharp decline in Japanese banks' business in the first quarter of the year does not conform to usual seasonal pattern, and may reflect pressures on banks to restrain balance sheet growth as the result of concerns to meet BIS capital ratios. The main area of reduced activity was business with other banks overseas.

Table D
Fixed-rate bond issues by country of issuer
Percentages by value of total issues announced

Country of issuer	1990 Year	Q3	Q4	1991 Q1
United States	9	10	6	5
United Kingdom	7	7	8	11
Japan	24	32	26	17
Germany	4	3	2	3
France	9	7	11	6
Canada	6	4	8	12
Australia	3	4	4	1
Italy	4	3	4	8
International institutions	14	13	14	15
Other	20	17	17	22

Canadian dollars rose sharply, partly swap-driven but also stimulated by maturities requiring refinancing against a background of strong investor demand. However, the increase in new issues was largest in Ecu, where issues equivalent to more than $17 billion were launched, nearly three times the previous highest quarterly level. A substantial proportion of the Ecu issues were by European sovereign governments, including the United Kingdom, Italy and Belgium, and supranational bodies (see the note on page 216). Average daily turnover in the secondary bond market was considerably higher in the first quarter than in the second half of last year (see the chart). The increase in trading of Ecu bonds—stimulated by the rise in new issues—was the main contributor.

Straight eurobonds: secondary market turnover



Bond issues by UK borrowers in foreign currencies in the first quarter of 1991 totalled $6.5 billion, around half of which was accounted for by the UK Government's ECU 2.5 billion bond (see page 210). Excluding this issue, bond issues totalled $3.0 billion, up $0.4 billion on the previous period. Of the total foreign currency bond issues during the quarter, 11 of the 25 issues, or over 35% by value, were denominated in dollars.

In the equity-related sector, the volume of new issues was broadly unchanged compared with the fourth quarter, despite the rise in Japanese equity prices. Investor interest in those issues launched in the first quarter was strong compared with the second half of last year, reflecting the improved performance of the equity market, but in the first quarter borrowers appeared to prefer the alternative opportunities presented by straight bonds.

Issues of floating-rate notes declined further in the first quarter, to only $5.9 billion. Roughly one third of the (few) issues in the sector were in sterling; the relative resilience of the sterling sector reflected an increase in issues of mortgage-backed bonds, which recovered strongly from the low levels last year. This reflected the fall in interest rates and the narrowing of spreads on mortgage-backed bonds (perhaps reflecting the prospect of a less depressed UK housing market), both of which attracted borrowers.

The value of announced euronote facilities declined in the first quarter (Table E), though the euro medium-term note market continued to grow, owing particularly to two large public sector announcements. The tight credit conditions and increased uncertainties in recent quarters have enhanced the attractiveness of utilising underwritten (committed) facilities, under which a bank provides a commitment to underwrite a programme (rather than offering 'best efforts' to place the notes): the share of underwritten facilities increased for the third successive quarter, accounting for 17% of the total outstanding at the end of March.

Table E
Announced euronote facilities [(a)]
$ billions

Nationality of borrower	1989 Year	1990 Year	Q2	Q3	Q4	1991 Q1
United States	11.7	14.8	2.4	2.0	4.0	0.5
United Kingdom	6.1	8.4	2.9	3.1	1.9	2.2
Australia	13.2	10.4	4.1	0.9	2.2	0.9
Japan	10.1	6.3	0.6	1.0	1.4	1.8
Other OECD	26.0	29.9	6.2	4.8	11.8	9.0
Other	5.4	3.1	0.8	0.8	0.3	0.7
Total	**72.5**	**72.9**	**17.0**	**12.6**	**21.6**	**15.1**

(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).

Table F
Announced eurocurrency syndicated credits[(a)]
$ billions

	1989 Year	1990 Year	Q2	Q3	Q4	1991 Q1
Major OECD	98.6	94.0	20.3	20.0	29.6	11.1
Minor OECD	25.8	28.8	6.5	7.8	5.5	13.2
Developing countries	25.0	30.0	7.9	8.7	6.9	12.5
Eastern Europe	2.2	12.1	3.6	7.1(b)	1.4	1.1
Other	0.2	0.3	—	—	0.1	0.3
Total	**151.8**	**165.2**	**38.3**	**43.6**	**43.5**	**38.2**

(a) Includes those syndicated loan facilities which may allow a borrower to increase its liabilities partly of wholly in foreign currency (from the borrowers' point of view) and/or involving an international capital flow.

(b) Of which borrowing by East Germany accounted for $5.3 billion.

The volume of announced syndicated credits fell back slightly in the first quarter, reflecting the increasingly selective attitude of the banks, widening margins and the attractions to borrowers of bond finance, and recession in the United States and the United Kingdom (Table F). Finance for acquisitions was notably absent in the first quarter; the largest announcement related to a debt refinancing.

Ecu banking and bond market activity[1]

International Ecu-denominated assets of banks in the BIS reporting area rose by 6% between March and September 1990. Five centres within the BIS reporting area (United Kingdom, France, Belgium, Italy and Luxembourg) accounted for some 81% of Ecu-denominated banking activity at end-September, a slightly lower share than six months earlier (see Table 1). Over three quarters of BIS banks' lending in Ecu is to other banks; between end-December 1989 and end-September 1990, Ecu-denominated bank lending to non-banks grew by 10%, or only about half as fast as interbank lending.

Table 1: Ecu lending by BIS-area banks
Ecu billions, amounts outstanding at end-periods: *percentages in italics*

	1989	1990		
	Dec.	Mar.	June	Sept.
Total international assets	**124.5**	**136.7**	**137.4**	**144.9**
of which:				
Banks	93.5	104.6	104.1	110.9
Non-banks	31.0	32.1	33.3	34.1
of which:				
United Kingdom	*29*	*31*	*30*	*30*
France	*20*	*18*	*16*	*17*
Belgium	*13*	*12*	*11*	*11*
Italy	*15*	*14*	*14*	*13*
Luxembourg	*9*	*9*	*9*	*10*

Source: BIS.

London continues to be the largest centre for Ecu banking business in Europe, accounting for 30% of total lending by BIS-area banks, or as much as the next two largest European centres put together. The Ecu assets of banks in London continue to be well matched by Ecu liabilities. The increasing importance of Ecu business is reflected in the rise in the Ecu's share of total outstanding cross-border lending by banks in the United Kingdom—from 2.7% at end-March 1989 to 3.2% a year later and to 3.6% at end-December 1990. The Ecu continues to be the sixth largest currency denomination for external lending by banks in the United Kingdom.

Table 2: Ecu business by banks in the United Kingdom
Ecu billions, amounts outstanding at end-periods

	1989	1990			
	Dec.	Mar.	June	Sept.	Dec.
Total liabilities	**33.1**	**41.2**	**40.0**	**41.3**	**42.3**
of which:					
UK banks	7.4	9.1	8.2	9.0	8.6
Other UK residents	1.2	1.2	1.6	1.7	1.9
Overseas residents	22.3	25.8	27.3	28.2	29.0
Forward sales	38.7	55.8	54.6	57.4	50.9
Total assets	**36.2**	**41.9**	**41.9**	**44.2**	**43.6**
of which:					
UK banks	6.2	8.5	7.0	8.0	8.2
Other UK residents	2.2	2.7	3.0	2.3	2.4
Overseas residents	21.3	23.3	24.9	27.4	25.9
Forward purchases	38.8	71.0	55.1	54.7	42.2

Source: Bank of England.

Ecu bonds

The sharp upturn in primary market activity in the Ecu bond market in 1990 accelerated in the first quarter of 1991. Ecu bonds accounted for over 18% of total issues of international bonds between January and March this year, second only to the US dollar (Table 3). Outstanding international Ecu bond issues have risen from ECU 45.9 billion at end 1989 to ECU 56.7 billion at the end of December 1990.

Sovereign and supranational issues have accounted for about half of new issues, and took a larger share in the first quarter of 1991 (Table 4). Large issues by sovereign and supranational borrowers, notably the United Kingdom's first Ecu bond issue

Table 3: International bond issues by currency of denomination
Percentages

	1987	1988	1989	1990		1991
	Year	Year	Year	Year	Q4	Q1
US dollars	35.8	36.8	49.5	33.2	27.4	29.5
Ecu	4.2	4.9	4.7	7.8	10.6	18.2
Yen	14.1	9.1	9.2	12.4	17.7	10.3
Deutschemarks	8.5	10.4	6.1	12.5	12.5	4.4
Canadian dollars	3.4	5.8	4.8	2.5	3.4	8.8
Swiss francs	13.6	11.8	7.3	9.0	9.2	6.4
Sterling	8.5	10.8	8.2	8.5	8.8	9.0
Other	11.9	10.4	10.2	14.2	19.4	13.4

Source: Bank of England ICMS database.

Table 4: International Ecu issues: cumulative total by country and sector of borrower [a]
Ecu million, as at end-March 1991

	Banks	Financial	Government sector	Other private sector	Supra-national organ-isation	Total
Belgium	689	550	2,050	153	—	**3,442**
Denmark	397	110	1,585	105	—	**2,197**
France	2,277	2,435	4,243	5,051	—	**14,006**
Germany	1,245	200	—	125	—	**1,570**
Italy	1,490	420	6,428	1,666	—	**10,004**
Japan	1,837	240	220	2,739	—	**5,036**
United Kingdom	340	390	2,500	695	—	**3,925**
United States	1,676	375	—	4,667	—	**6,718**
Unallocated	—	—	—	75	16,546	**16,621**
Other	4,026	2,608	5,573	2,998	—	**15,205**
Total	**13,977**	**7,328**	**22,599**	**18,274**	**16,546**	**78,724**

(a) The table refers to gross issues, and does not take into account redemptions.

(see pages 210–11), in particular, have helped the market's development by creating liquid benchmarks from which other issues can be priced and by helping to broaden the investor base for Ecu bonds by attracting international investment demand. The average size of international Ecu bond issues expanded from ECU 96 million in 1989 to over ECU 185 million in 1990.

Secondary market turnover in Ecu bonds increased by over 80% between 1989 and 1990, rising from an average equivalent of \$49 billion a quarter to \$90 billion a quarter (Table 5); in the first quarter of 1991 turnover in Ecu bonds was almost \$200 billion. Ecu bonds also significantly increased their share of total turnover—Ecu bonds comprised about 5% of international bonds outstanding at end-1990, but accounted for 22% of total secondary market turnover in the first quarter of 1991.

Table 5: Secondary market bond turnover
\$ billions; *percentages in italics*

	Ecu	Total activity	Ecu share in total
1989 Q1	53.2	528.9	*10.1*
Q2	46.3	638.0	*7.3*
Q3	44.7	586.5	*7.6*
Q4	52.7	587.4	*9.0*
1990 Q1	79.3	632.0	*12.5*
Q2	88.5	625.2	*14.0*
Q3	109.9	686.2	*16.0*
Q4	84.4	782.7	*10.8*
1991 Q1	199.0	919.4	*21.6*

Source: Euroclear, Cedel.

The broadening of the investor base and growth in turnover has been accompanied by an expansion in the number of securities firms involved in trading and syndicating Ecu issues, notably through the involvement of non-European firms operating from London. This has helped London develop further as the main centre for international Ecu bonds.

(1) See 'ECU banking and bond market activity' in the August 1990 *Bulletin*, pages 345–51.

Domestic markets

New issues and turnover

Total sterling capital issues announced in the first quarter of 1991 rose substantially to £6.5 billion, the highest level since the third quarter of 1989. This upturn, from the depressed market in the second half of 1990, reflected an increase in the value of issues by both UK and overseas borrowers; equity issues were particularly strong (Table G).

Table G
Sterling capital issues: amounts announced[a]
£ millions

	UK borrowers(b)			Overseas borrowers	
	Shares(c)	Fixed-rate debt	Floating-rate debt	Shares and fixed-rate debt	Floating-rate debt
1988	7,177	5,933	5,648	3,681	—
1989	7,715	7,677	5,808	4,648	36
Q1	835	3,304	725	1,205	—
Q2	3,074	1,904	1,500	1,130	—
Q3	2,008	1,902	1,669	1,543	36
Q4	1,798	567	1,915	769	—
1990					
Q1	1,574	1,555	1,300	1,122	350
Q2	1,431	1,631	2,312	550	60
Q3	1,355	888	929	—	290
Oct.	251	381	475	—	—
Nov.	580	567	525	555	—
Dec.	116	408	—	95	—
Q4	947	1,356	1,000	650	—
1991					
Jan.	661	410	509	614	—
Feb.	195	466	249	490	—
Mar.	1,371	956	150	247	175
Q1	2,227	1,832	908	1,378	175

(a) Further details can be found in the Bank's monthly Capital Issues Press Notice.
(b) Including issues by overseas financing subsidiaries.
(c) Shares comprise ordinary shares and preference shares including convertible preference shares. Only those issues which raise new money for the issuer are included; therefore sales of shares by the Government (eg the electricity privatisations) are excluded.

The increase in activity followed the lessening of uncertainty over the Gulf from mid-January, and was encouraged by the gradual reductions in interest rates, which, together with advances in stock markets abroad, stimulated an equity market rally and encouraged issuers to return to the market to raise funds. Rights issues have accounted for a large part of the new equity finance raised, particularly in the second half of March, when ten such issues were announced, raising over £1 billion (the largest being the £558 million issue by Bass). March also saw the largest fixed-rate issue for some two years—a £350 million sterling bond issued by British Gas plc. The new issues allowed companies to restructure their balance sheets, tap the liquidity built up by institutional investors during 1990, raise funds more cheaply than borrowing from banks and, where new equity was raised, to reduce their gearing ratios.

Turnover in domestic equities in London was just under £1.5 billion per day during the first quarter,[1] nearly 25% higher than in the previous three months. Trading volumes picked up with Allied successes in the Gulf and as interest rates declined. In March, equity market turnover averaged £1.8 billion per day, the highest monthly average since January 1989, with a peak of £2.7 billion traded on 6 March, when the FTSE 100 rose above the previous record set in January 1990. The index reached further new highs later in March and in April.

Average daily turnover in the gilt market rose to £4.5 billion per day in the first quarter, up from £3.8 billion per day in the previous period. Turnover was stimulated by new gilt issuance (see page 209) and the gradual declines in UK and overseas interest rates.

Gross issues of sterling commercial paper[2] totalled £12.4 billion during the first quarter of 1991, up from £11.8 billion in the previous quarter, and increasing the amount outstanding by £1.1 billion to £5.9 billion at end-March. By the end of the first quarter the Bank had been notified of 266 sterling commercial paper programmes, and paper has been issued under 219 of these. During the period the Bank was notified of 3 medium-term note programmes, taking the total to 11.

Cash markets

February and March saw an encouraging increase in equity market turnover in London, but, as in other centres abroad, earlier declines in market turnover during 1990 resulted in pressures on financial firms to reduce costs and improve profitability. The London Stock Exchange was also affected by the downturn in the market in 1990, and has cut overheads by shedding staff. The opportunity has been taken to reorganise the structure of the regional offices of the Exchange. The Exchange has announced plans to reform its constitution. The proposals, to be voted on in July, suggest replacing the Council with a smaller Board of Directors, with representation drawn from a broader range of users of the Exchange's services.

Unfavourable market conditions have affected planned large-scale pan-European projects by stock exchanges: for example, the postponement of the launch of the NASDAQ International trading system and diminished support from shareholders for the proposed Euroquote information dissemination service.

In February the London Stock Exchange launched a new pan-European share index, Eurotrack 200, which includes the 100 UK shares comprising the FTSE 100 as well as constituents of its existing Eurotrack 100 index of the top continental European stocks.

Derivatives

Daily average turnover on the London derivatives exchanges grew by 16% in the first quarter compared with the last quarter of 1990, and was 13% higher than the same period last year. The principal factor was growth in volumes on LIFFE. Turnover on the International Petroleum Exchange

(1) See also the article on 'Global equity turnover: market comparisons' (page 246).
(2) Made under the Bank's notice of 11 January 1990.

Some recent reforms and modernisation in Italian and Belgian financial markets

Parallel to the single market programme in the EC, the authorities in many countries have undertaken financial market reforms. In recent years there have been reforms in France, Spain and the Netherlands. During the last six months, significant reforms have been instituted in securities markets in Italy and Belgium, and there have been further reforms in Germany. These reforms have had similar motivation: to improve financial market efficiency and international competitiveness. In some countries the migration of wholesale securities business from domestic exchanges to interbank and international markets has been a major impetus for reform.

In Europe, most of the reforms have required primary legislation. This has reflected the traditional quasi-official status of stockbrokers in many countries, under which they have enjoyed a legal monopoly of customer securities business. One of the main reforms in Belgium (like the earlier reforms in Paris) has been to change the status of stockbrokers to private limited companies ('sociétés de bourse') and to open up the capital of the existing firms to banks and other financial institutions. These measures are already in force; but only from 1 January 1992 will banks and financial institutions be able to create new 'sociétés de bourse' in Belgium; and direct membership of the Belgian Stock Exchange by banks will not be possible.

The recent Italian reforms have had a somewhat different emphasis, reflecting the highly fragmented securities market in Italy, involving many different types of financial intermediary, many of which have been unsupervised. From the beginning of 1992, a new type of institution will be created—the 'Società di Intermediazione Mobiliare', or SIM (securities company)—to undertake all securities-related activities including new issues and fund management. Banks and other institutions will be able to own SIMs and banks will also be able to continue to undertake, in competition with SIMs, most of their current securities-related activities; however, as in Belgium, direct membership of the stock exchanges, currently the preserve of the 'agenti di cambio' (stockbroking firms), will be not be open to banks, being reserved exclusively for SIMs.

In both Belgium and Italy a major preoccupation of stock exchange authorities and legislators has been addressing the interests of the existing stockbroking community, including the many small and medium-sized firms, and those of the banks.

In Italy existing interests have been protected by a requirement for every SIM to have the participation of existing 'agenti di cambio' until the end of 1992; this mirrors earlier Spanish reforms where the participation of 'agentes de cambio' in the capital of the new 'sociedades' and 'agentes de valores y bolsa' is required until 1 January 1992. Many banks in Belgium have already made alliances with existing broking firms.

The new legislation in both Belgium and Italy includes requirements designed to concentrate securities business on existing stock exchanges and diminish the trading which currently takes place involving banks away from the exchanges (in Italy around 70% of securities trading is estimated to be off-exchange).

Government debt markets also have been the focus of reform. Following the United Kingdom's example in introducing a system of primary dealers (the gilt-edged market makers, in 1986), an increasing number of EC countries, including France in 1987 and Italy in 1988, have set up primary dealer groups to help to increase liquidity. Belgium has followed suit this year and has approved 14 banks as primary dealers (including three foreign banks).

The success of futures markets in London and Paris has encouraged reform elsewhere in Europe. Since 1990 futures and options have been enforceable in Germany with the creation of the Deutsche Terminbörse. Belgium too will soon have a new futures and options market, Belfox, while in Italy the so called SIMs law makes provision for the authorisation of futures and options trading.

It is of interest that, despite the increasing integration of EC financial markets, the market structures adopted recently in countries such as Belgium and Italy, as well as France and Spain, differ significantly in certain areas (for example direct access for banks to the stock exchanges and the concentration of business on organised markets) from existing structures in Germany, the Netherlands and the United Kingdom.

was boosted by hostilities in the Gulf in January and February though activity fell slightly in the quarter as a whole.

As confidence improved with developments in the Gulf and as anticipated (and actual) base rate cuts fuelled interest in sterling derivatives, LIFFE achieved record turnover in February, followed by strong activity in March. The Bund future remained the exchange's most heavily traded product, trading a daily average of over 44,000 contracts. Daily turnover on the Deutsche Terminborse's identical, but screen-traded, Bund future averaged 4,230 contracts in this period; open interest in DTB's contract at end-March was one tenth of LIFFE's.

Turnover in long gilt futures on LIFFE averaged 21,300 contracts per day, up 3,200 contracts per day on the seasonally low activity in the final quarter of 1990. The outbreak of Gulf hostilities on 17 January stimulated turnover of 38,700 contracts, close to the quarter's peak of over 39,500 contracts on 25 February. The volume of trading was also relatively high around the time of the interest rate cuts and after the Budget.

During the first quarter £130 million of call warrants exerciseable into gilt-edged stock were issued which, in combination with maturities of £100 million, increased the amount outstanding from £200 million to £230 million. There were also issues of £30 million of put warrants over the period—the first issues for some two years.

Turnover in the short sterling futures contract on LIFFE rose to 40,400 contracts per day, from 35,600 in the previous period. Peaks in turnover accompanied the three reductions in interest rates, with over 60,000 contracts traded on 27 February and 22 March and 80,000 traded on 13 February.

LIFFE has continued to widen its international product range. In February, the exchange launched a three-month Euro-Swiss franc interest rate future, turnover in which averaged just under 2,000 lots per day in the first five weeks of trading. SOFFEX, the Swiss Futures and Options Exchange, introduced a competing Swiss franc future in March. LIFFE also launched a physically deliverable Ecu bond contract in March: a range of 6–10 year AAA-rated bonds issued by governments and supranational bodies are currently eligible for delivery against the contract. Its specifications differ from those of MATIF's contract launched six months previously, but the two are nonetheless in competition.

Trading of derivatives of UK equities has grown markedly over the last couple of years, especially in relation to trading of the underlying equities (Table H). While the value of turnover in UK equities in 1990 was about 39% below its 1987 peak, the value of equity represented by derivatives trading has grown in absolute terms, and in 1990 equalled turnover in the cash market. In the United States, where derivatives trading is longer established, the value of equity represented by derivatives trading is estimated to be four times as large as trading in the underlying cash markets.

The doubling of the value of UK equity represented by derivatives trading between 1988 and 1989 mainly reflected an increase of 157% in the trading of futures and options on the FTSE index (trading of individual stock options declined more or less in line with volumes in the cash market). The increased trading of FTSE index derivatives may reflect the lower liquidity of the cash market following the 1987 crash and the change in the tax treatment of derivatives traded by pension funds and unit trusts in the 1990 budget. The greater sophistication in hedging techniques and increased arbitrage between the cash market and derivatives in London may also have played a part, together with the growing maturity of the market since the FTSE future was launched in 1984. It is worth noting that when turnover in the cash market picked up in the first three months of this year the ratio of trading in equity derivatives to cash market turnover declined.

Table H
Turnover in UK equities and equity derivatives
£ millions per day

	1987	1988	1989	1990	1991 Q1
FT-SE futures	92	83	224	315	356
FT-SE options	71	84	205	236	200
Stock options	118	71	86	66	73
All equity-related derivatives (a)	281	238	515	617	629
Domestic equity (single counted) (b)	1,029	629	784	626	747
Derivatives as a percentage of cash market	27	38	66	99	84

(a) Value of equities represented by the derivatives.
(b) Derivatives turnover is normally single counted; therefore reported equity market turnover has been halved to give a correct comparison.

Settlement

TAURUS, the book entry transfer system being developed by the Stock Exchange for effecting electronic settlement of equity transactions, is now expected to be introduced next year. The draft regulations making provisions to enable title to be evidenced or transferred without the use of share certificates are expected to be published in May by the Department of Trade and Industry. Significant technical changes to computer message arrangements, a necessary part of the TAURUS development package, are being introduced by October this year.

At end-March CMO contained 69,000 instruments with a total value of £67 billion, and accounted for nearly 70% of the outstanding stock of money-market instruments, up from around 40% at end-1990. Bank certificates of deposit accounted for 48% of the instruments held in CMO, eligible bank bills 33% and Treasury bills 12%. The proportion of gilt-edged stock held in CGO has remained around 70% since mid-1990.

Regulation

On 1 April, the AFBD and TSA merged to form the Securities and Futures Authority (SFA), the Self Regulating Organisation for the securities and futures business in the United Kingdom. The Securities and Investment Board (SIB) has embarked on a review of retail regulation. The SIB has also published the final version of the 'core' conduct of business rules and draft rules on the marketing regime for the new categories of authorised unit trusts, including futures and options funds.

In the United States, the Treasury introduced its proposals for major reform of the US deposit and banking systems. The proposals include full interstate branch banking within three years; limits on the scope of deposit insurance coverage; the consolidation of supervisory responsibility under the principle of a single regulator for each bank; allowing commercial ownership of banks and allowing banks full entry into the securities and insurance businesses. Legislation based on the proposals was introduced to Congress in March, although the prospect for its passage is highly uncertain.