Financial market developments

The strong advance in equity and bond prices seen in the first quarter of 1991 petered out in the second. Prices in several markets ended the quarter slightly lower than at end-March as concern over the underlying strength of economies re-emerged (Table A). Share prices in the United Kingdom and the United States temporarily reached record levels, encouraged partly by optimism over interest rates and the prospects for economic recovery, but in real terms they remained below pre-1987 crash peaks. The German equity market rose more quickly than in the relatively subdued first quarter, but the Japanese market was depressed by poor results from the financial and corporate sectors, and latterly by revelations about the trading practices of Japanese securities companies. Overall, there was little movement in short-term interest rates over the quarter, with continued easing in a number of economies (notably Japan and the United Kingdom) while the downward trend flattened out in the United States. Yields on government bonds rose modestly in most countries, reflecting revised expectations about future interest rates, and yield curves either steepened or became less inverted. In the foreign exchange markets, the dollar strengthened further after its strong appreciation in the first quarter, and was accompanied by a stronger yen.

Table A
International financial markets: key indicators

	1990		1991	
	1 Aug: pre-invasion	31 Dec.	28 Mar.	28 June
United Kingdom				
Equity market: FT-SE 100	2,339.0	2,143.5	2,456.5	2414.8
10-year government bond yield %	11.7	11.0	10.1	10.6
3-month Treasury bill yield %	14.8	13.8	11.6	11.0
United States				
Equity market: S&P 500	355.3	330.2	375.2	371.2
10-year government bond yield %	8.3	8.1	8.0	8.2
3-month Treasury bill yield %	7.7	6.6	5.9	5.7
Canada				
Equity market: TSE Composite	3,569.0	3,256.8	3,495.7	3,465.8
10-year government bond yield %	10.5	10.3	9.5	10.1
3-month Treasury bill yield %	13.2	11.4	9.7	8.7
Japan				
Equity market: Nikkei 225	30,838.0	23,848.7(a)	26,292.0 (b)	23,291.0
10-year government bond yield %	7.2	6.6(a)	6.6 (b)	6.9
3-month Treasury bill yield %	7.6	7.6(a)	7.9 (b)	7.7
Germany				
Equity market: DAX	1,892.9	1,398.2(a)	1,522.8	1,622.2
10-year government bond yield %	8.5	9.0(a)	8.5	8.5
3-month interbank interest rate %	8.1	9.3(a)	9.1	9.1
France				
Equity market: CAC General	525.9	413.0(a)	479.8	470.8
10-year government bond yield (OAT) %	9.5	10.0(a)	9.1	9.1
3-month Treasury bill (BTF) discount rate %	9.4	9.6(a)	9.1	9.4
Italy				
Equity market: BCI	721.9	519.4	581.2	586.2
7-year government bond yield %	14.0	14.5	13.7	13.3
3-month interbank interest rate %	11.8	13.8	11.9	11.7
World equity index				
Financial Times World Index:				
US dollar index	146.7	129.8	142.1 (b)	136.5
Local currency index	135.9	115.6	131.0 (b)	128.0

(a) 28 December.

(b) 29 March.

Against the background of generally less buoyant prices, primary activity in the international debt markets eased back somewhat in the second quarter. Nevertheless, issues of bonds remained strong on a longer-term comparison. This may suggest that the switch by some borrowers towards more reliance on capital markets than bank finance in the first quarter(1) was not wholly the product of improvement in market conditions, but may have reflected higher intermediation costs and some movement towards less reliance on bank finance, at least for borrowers of high credit standing.

The cautious attitude of the banks, and a preference by a number of banks for bilateral deals, appears to have restricted syndicated lending in the second quarter. It may have dampened lending for mergers and acquisitions in recent months, which was already restricted by lack of demand. Notwithstanding the evidence of a more restrained role for banks as intermediaries, the scope for a widespread switch to capital markets is limited by the inability of many borrowers to secure access to markets directly because their needs are too small or their credit standing is not high enough. Credit concerns, reflected in a record number of downgradings of US corporations' bond ratings this year, may have restricted access of lower rated companies to international bond markets. The share of new issues of eurobonds rated at single 'A' or below fell from 15% in 1988 to 8% in 1990 and 5% in the first half of this year. There was an increase in asset-backed debt issues, with the demand for credit enhancement being exemplified by the recent introduction of a market index for such issues. There have also been indications of increased recognition by borrowers of the value of good long-term banking relationships, which can help companies through difficult trading conditions.(2)

Banks are remaining cautious, not only with regard to the quality of individual borrowers but also in respect of balance sheet growth as a whole. This reflects continued pressures

(1) See the May 1991 *Bulletin*, pages 212–15.
(2) See the speech by the Governor 'Corporate finance, banking relationships and the London Rules' reproduced in the November 1990 *Bulletin*, pages 511–13.

International banking developments

In the first quarter of 1991, the external assets and liabilities of BIS reporting banks fell for the first time since 1984 (assets -$54.8 billion, liabilities -$30.3 billion). This mainly reflected unprecedented contraction in cross-border interbank business within the reporting area (assets -$79.5 billion, liabilities -$74.2 billion). This was mainly attributable to Japanese banks, whose balance sheets usually expand at the end of the April–March financial year, and reflected pressures on their capital ratios.

BIS reporting banks' business with countries outside the reporting area contracted in the first quarter (assets -$5.5 billion, liabilities -$20.4 billion) primarily reflecting a sharp decline in business with Middle East oil producers. Following the unfreezing of its assets, Kuwait's identified deposits fell by $2.5 billion, while $2.8 billion of Kuwaiti interbank borrowings were repaid. The deposits of Egypt rose by $1.5 billion and those of Jordan by $0.6 billion.

Net claims on South Korea, Thailand, Taiwan and Malaysia rose, financing deteriorating current accounts. Banks' claims on Latin America rose by $0.8 billion, more than accounted for by new lending to Mexico ($1.4 billion). Claims on eastern Europe rose by $0.4 billion, but these mainly represented interest arrears, with the largest increases in claims for the Soviet Union ($0.7 billion) and Poland ($0.4 billion). Banks' business with African countries showed a record fall as did business with developed countries outside the reporting area, especially Australia, Greece and Yugoslavia.

Cross-border business of banks in the United Kingdom

$ billions: changes exclude estimated exchange rate effects

	1990 Year	Q1	Q2	Q3	Q4	1991 Q1	Out-standing at end-Mar. 1991
Liabilities vis-à-vis:							
BIS industrial area	74.0	16.3	-5.3	27.8	35.2	-12.2	743.0
of which:							
United States	*3.9*	*-16.2*	*1.2*	*8.7*	*10.2*	*-9.7*	*148.6*
Japan	*-6.8*	*4.8*	*-9.7*	*2.4*	*-4.3*	*-2.7*	*102.5*
'Offshore' banking centres	-1.5	0.6	-4.1	1.2	0.8	-2.6	117.8
Sub-total	72.5	16.9	-9.4	29.0	36.0	-14.8	860.8
Outside reporting area							
Developed countries	1.6	0.7	-0.5	2.1	-0.7	-2.6	31.0
Eastern Europe	-0.9	-1.0	-0.9	0.6	0.4	-1.6	3.9
Oil exporters	11.9	1.0	—	5.5	5.4	-1.2	68.0
Non-oil developing countries	6.6	0.5	2.6	2.3	1.2	-1.0	55.7
of which, Latin America	*2.1*	—	*0.9*	*0.8*	*0.4*	*-0.2*	*7.7*
Sub-total	19.2	1.2	1.2	10.5	6.3	-6.4	158.6
Other (a)	4.8	2.4	6.2	2.5	-6.3	20.1	116.8
Total (d)	**96.5**	**20.5**	**-2.0**	**42.0**	**36.0**	**-1.1**	**1136.2**
Assets (b) **vis-à-vis:**							
BIS industrial area	81.8	23.4	-2.2	43.2	17.4	-2.1	758.3
of which:							
United States	*18.9*	*-0.7*	*3.7*	*5.2*	*10.7*	*-12.9*	*136.0*
Japan	*1.5*	*0.6*	*-9.6*	*13.0*	*-2.5*	*-10.7*	*205.5*
'Offshore' banking centres	6.5	0.4	5.1	2.6	-1.6	-4.4	123.0
Sub-total	88.3	23.8	2.9	45.8	15.8	-6.5	881.3
Outside reporting area							
Developed countries	-0.1	-0.6	1.1	0.3	-0.9	-1.0	32.7
Eastern Europe	-4.6	-0.9	-1.5	-1.3	-0.9	-1.2	15.0
Oil exporters	-1.5	-0.2	-0.7	-0.5	-0.1	-2.5	15.3
Non-oil developing countries	-3.2	-2.8	-2.0	0.6	1.0	2.0	44.4
of which, Latin America	*-5.2*	*-3.1*	*-2.5*	*-0.1*	*0.5*	*1.1*	*24.1*
Sub-total	-9.4	-4.5	-3.1	-0.9	-0.9	-2.7	107.4
Other (c)	5.7	-1.7	3.8	5.8	-2.2	1.7	21.7
Total (d)	**84.6**	**17.6**	**3.6**	**50.7**	**12.7**	**-7.5**	**1010.4**

(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 external assets of banks in the United Kingdom fell by $7.5 billion in the first quarter (the first fall since the second quarter of 1989). The main factor was a considerable reduction in interbank activity. The decline in cross-border claims of banks in the United Kingdom was evident across all geographic groupings, but was largest *vis-à-vis* the United States and Japan (which registered falls of $12.9 billion and $10.7 billion respectively, the majority of which were interbank). The fall in claims on banks in Japan was against the usual seasonal pattern, and probably reflected pressure to restrain balance sheet growth. Lending to Eastern Europe, which fell by $4.6 billion during 1990, declined by a further $1.2 billion in the first quarter of 1991, reflecting the cautious attitude of banks to the difficult conditions there. Claims on offshore centres also contracted, particularly on Singapore (-$2 billion) and the Bahamas (-$1.6 billion). Lending to Mexico rose by $1.3 billion in the first quarter, the third successive quarterly rise, underlining the country's steady return to the market.

The total cross-border liabilities of banks in the United Kingdom fell by $1.1 billion in the first quarter. Within the total, deposits registered a fall of £21.2 billion, which was largely offset by a rise in other cross-border liabilities of $20.1 billion, of which certificates of deposit accounted for $15.2 billion. The fall in cross-border deposits was largely accounted for by lower deposits from countries in the BIS area, which decreased by $12.2 billion, notably from Belgium ($10.8 billion), the United States ($9.7 billion) and Japan ($2.7 billion). Of the fall in deposits from outside the BIS area, Greece ($1.1 billion), Portugal ($0.5 billion) and Cyprus ($0.4 billion) were prominent. Cross-border business with offshore centres contracted overall, despite an increase in deposits from the Cayman Islands and Hong Kong.

The restraint in balance-sheet growth by Japanese-owned banks resulted in a reduction in their share of UK banks' external assets from 34.3% in the fourth quarter of 1990 to 31.8% in the first quarter of 1991. The shares of British and American incorporated banks remained unchanged at 13.4% and 13.9%, respectively, while the share of the 'other overseas' banks rose to a record 40.9%.

Preliminary figures for the second quarter of 1991 show a very sharp decline in the cross-border business of banks in the United Kingdom, with liabilities and claims down by $44.1 billion and $40.0 billion respectively. As in the first quarter, interbank business accounted for most of the fall. The falls in the second quarter were principally accounted for by 'other overseas' banks (liabilities -$33.3 billion, assets -$30.5 billion), and British-owned banks (liabilities -$14.8 billion, assets -$10.3 billion). The international business of American-owned banks grew marginally during the quarter, while the business of Japanese-owned banks was subdued.

on banks' capital ratios, despite increased recourse to capital markets by some banks, and may help to explain the fall in activity in the interbank market (see the note on page 354). Lower interbank activity also reflects the continued increase in the use of derivative products to manage interest rate risk off balance sheet. The effects of these developments may be different for different categories of bank. Lower interbank activity, and the tougher application of limits, might be expected to disadvantage smaller and less diverse banking operations, particularly those without large retail deposit bases.

Banks have continued to try to improve their capital ratios by issuing more capital as well as by restraining balance sheet growth. International capital market issues generally slowed in the second quarter but issues of bonds and MTNs by banks and financial institutions increased by about a third, to over $35 billion. So far this year, US and Japanese banks in particular have been active in raising finance in international capital markets, reflecting stronger pressures on their capital ratios than for other banks. US bank share prices strengthened somewhat relative to equity markets generally in the second quarter, as investor perceptions about the outlook for a number of banks improved in recognition of efforts to restore profitability and strengthen capital positions. But the performance of other banks' share prices has been poorer.

Despite the banks' efforts to raise new capital and to concentrate more on profitable business, the overall outlook for international banking activity is not buoyant. The emphasis on controlling risks in relation to potential returns on capital and on profitability rather than balance sheet growth is continuing to increase. Further steps by banks towards restructuring or consolidation have been taken (for example the recent proposed merger between Chemical Bank and Manufacturers Hanover).

There was further evidence during the quarter of increased globalisation in financial markets. Issuance of global bonds increased, as did activity in the sterling and Scandinavian eurocurrency markets, the last reflecting decisions by Sweden and Finland (and, previously, Norway) to link their currencies to the Ecu. The liberalisation of capital movements in some countries (for example, in Scandinavia and France and Italy in 1990) has served to stimulate international interest in those countries' bond markets, which have also benefited from greater convergence within the EC and from developments in the swaps market. Thus there has been some tendency in recent quarters for an increase, albeit from a low level, in bond issues in the smaller European currencies. Such increases were, however, only muted in the second quarter, perhaps partly because of the attractions of issuing in dollars during this period. There were, however, signs of increasing international activity in certain domestic markets such as the German commercial paper market.

Further steps to increase the international competitiveness of domestic markets were taken by the Italian and Spanish authorities (for example, both announced new procedures to speed up the refunding of withholding tax on government bonds to foreigners), but the Portuguese authorities imposed restrictions on international access to their markets. The prospect of closer economic and monetary interlinkages between European countries has stimulated a number of cross-border link-ups within the EC, with the latest batch during the second quarter involving Spanish, Portuguese and Italian companies in banking and insurance.[1] That such links should sometimes be preferred to penetrating new markets through mergers or green-field approaches is perhaps not surprising, given the difficulty, expense and risk of setting up retail operations in an unfamiliar country. Co-operative link-ups can help to overcome the management, tax, legal and cultural problems associated with entering new markets and may also allow the partners to achieve lower costs through specialisation (with one partner, for example, providing the distribution channels and the other the funding and/or post-sales administration). Over the longer term, when experience has been gained in the new markets, it might be expected that rather less reliance might be placed on joint ventures; it seems likely that the costs of setting up large scale retail networks would continue to reduce the attractiveness of that route.

New debt issues and turnover in the international markets

Overall financing activity in the international markets declined from a record $156 billion in the first quarter of 1991 to $143 billion in the second (Table B). This decline reflected falls in public sector fixed-rate bond issues and in syndicated credit announcements, which were only partially offset by a strong recovery in equity-related debt issues.

Primary activity in the US dollar sector was resilient, partly reflecting refinancing, but also borrowers' anticipation of higher US yields and the attraction of dollar-denominated

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

	1989	1990			1991	
	Year	Year	Q3	Q4	Q1	Q2
Fixed-rate bonds						
Straights	150.0	171.9	36.4	49.8	81.1	59.9
Equity related	85.1	33.0	12.9	6.5	7.4	19.9
of which:						
Warrants	*69.6*	*22.6*	*9.8*	*4.8*	*5.5*	*13.1*
Convertibles	*15.6*	*10.4*	*3.1*	*1.7*	*1.8*	*6.8*
Bonds with non-equity warrants (currency, gold, debt)	0.5	0.1	—	—	0.1	—
Total	**235.6**	**205.0**	**49.3**	**56.3**	**88.6**	**79.8**
Floating-rate notes	27.1	57.6	29.6	7.3	5.9	6.5
Euronote facilities	71.8	70.5	12.6	21.4	21.1	25.0
Syndicated credits	151.7	165.1	43.6	43.6	40.0	31.2
Total	**486.2**	**498.2**	**135.1**	**128.6**	**155.6**	**142.5**

(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.

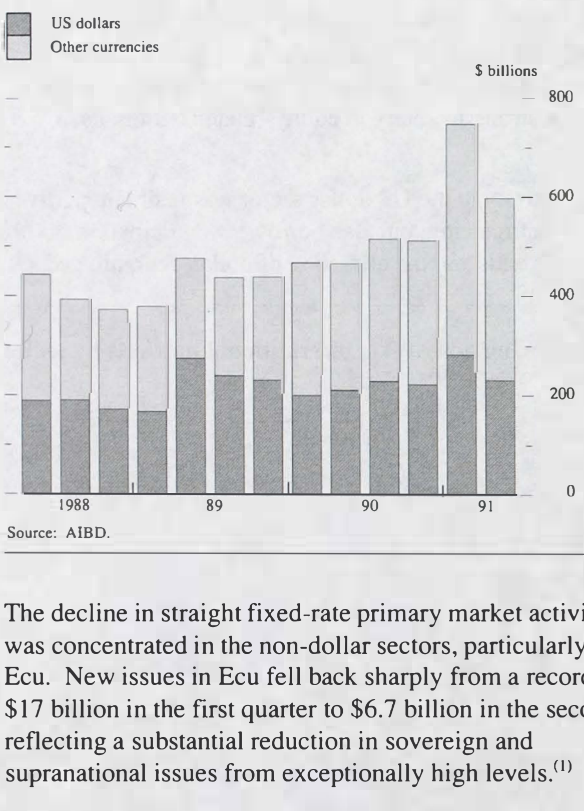
(1) There were a number of links established during the quarter between insurance companies and banks—perhaps partly reflecting the insurance opportunities in Europe. But there were also signs of insurance sector problems: top Japanese life insurance companies announced a notable decline in annual income, and the credit ratings of some major US insurers were reviewed.

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

	1990		1991	
Currency denomination	Year	Q4	Q1	Q2
US dollars	35	27	30	37
Swiss francs	12	11	7	7
Yen	15	19	11	11
Deutschemarks	5	4	3	7
Sterling	6	7	7	9
Australian dollars	4	4	2	1
Canadian dollars	3	4	9	7
Ecu	9	9	19	8
French francs	4	5	4	4
Other	7	10	8	9

assets to foreign investors in periods of dollar strength (Table C). The firm performance of the dollar attracted non-US investors to the eurodollar market, altering the relative balance of supply and demand in the domestic and international dollar markets. Average spreads over US Treasuries on prime eurodollar bonds narrowed in the second quarter, suggesting that credit concerns at the higher quality end of the bond markets may have begun to diminish. US corporations took advantage of this by issuing $3.6 billion of eurodollar bonds in the second quarter, reflecting also signs of a recovery in the US economy. Primary activity in the Yankee sector (dollar bonds issued by foreigners in the US domestic market) fell from $8 billion in the first quarter to $4.7 billion in the second. The fall in the volume of issues reflected periodic concerns regarding oversupply, unattractive swap rates, and a steep US dollar yield curve, which made medium and long-term issuance look expensive.

Straight eurobonds: secondary market turnover



Source: AIBD.

The decline in straight fixed-rate primary market activity was concentrated in the non-dollar sectors, particularly the Ecu. New issues in Ecu fell back sharply from a record $17 billion in the first quarter to $6.7 billion in the second, reflecting a substantial reduction in sovereign and supranational issues from exceptionally high levels.(1)

Primary activity in the sector was supported by Finland and Sweden independently announcing they were linking their currencies with the Ecu. This led to a substantial improvement in arbitrage opportunities, as swap rates shifted in response to efforts by Nordic participants to replace dollar borrowing by Ecu borrowing, sometimes to finance lending in higher-yielding domestic currency.

Issues of Canadian dollar bonds, at $5.8 billion, remained firm, partly swap driven, but also stimulated by low Canadian interest rates, and a continuing high level of redemptions. For much of the second quarter, the euro Canadian dollar market unusually offered lower yields than the domestic market. In contrast, issues of Australian dollar bonds declined to $0.7 billion, affected by currency weakness and poor swap opportunities. Issues of international yen-denominated bonds declined slightly over the quarter to $8.4 billion in reaction to the increase in Japanese interest rates in April and May. Nevertheless, expectations of a stronger yen and an easing of interest rates sustained demand, particularly towards the end of the quarter.

The increased linkage between euro and domestic markets was demonstrated by the issue of two global bonds totalling $2.6 billion, comprising a US dollar issue backed by credit-card receivables and a Canadian dollar issue by a Canadian utility. Since September 1989 seven borrowers have issued twelve global bonds, totalling $16.6 billion.

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

	1990		1991	
Country of issuer	Year	Q4	Q1	Q2
United States	9	6	5	12
United Kingdom	7	9	11	9
Japan	24	26	17	25
Germany	4	2	3	4
France	9	11	6	10
Canada	6	8	12	9
Australia	3	4	1	1
Italy	4	4	8	2
International institutions	14	14	15	7
Other	20	16	22	21

Foreign currency bond issues by UK borrowers continued strongly in the second quarter, totalling $3.3 billion and taking the total in the first half of 1991 to $6.3 billion (excluding the HM Government Ecu 2.75 billion bond in February).(2) There were eighteen foreign currency issues by UK borrowers in the second quarter, seven of which (or over two thirds by value) were in US dollars—the concentration in dollar borrowing perhaps reflecting borrowers' anticipation of higher dollar bond yields and favourable swap opportunities. The largest issue during the period was a $750 million fixed-rate issue from National Westminster Bank plc. The quarter also saw a number of lira-denominated issues by UK borrowers (four out of eighteen non-sterling UK issues, or 15% by value), in line with the increased use of a wider range of currencies in world bond markets.

(1) In the first quarter, several governments including that of the United Kingdom had launched a number of extremely large issues against a background of falling Ecu yields and strong demand (see the May 1991 *Bulletin*, pages 210–11 and 216).
(2) Ecu 2.5 billion was issued to the market, with a further Ecu 0.25 billion allocated to the Bank of England for use in lending operations.

Equity-related bond issues more than doubled to $19.9 billion, the highest level of new issues since the second quarter of 1989. Japanese corporations remained the largest single class of borrower, partly to refinance maturing equity warrant bonds but also attracted by the relatively low cost of such issues and difficulties in obtaining alternative finance. However, the weakness in Japanese equities has raised concern over the robustness of the market. Although the dollar continued to be the most popular currency, new issues in deutschemarks rose substantially, from $0.9 billion to $3.0 billion, reflecting cost advantages early in the quarter and a tendency for some borrowers to split deals into two tranches, one in deutschemarks and the other in dollars, reportedly in an effort to circumvent Japanese guidelines on the size of issues. There were several large convertible issues in sterling, with primary activity up from $0.5 billion equivalent in the first quarter to $1.9 billion in the second. There was also a notable increase, across a range of currencies, in convertible issues from $1.8 billion in the first quarter to $6.8 billion, though Japanese convertible issues continued to be low.

Issues of floating-rate notes increased marginally in the second quarter but remain well below the levels recorded during 1990. Primary and secondary FRN market activity has remained relatively subdued, despite a recovery in secondary market prices. Issues of deutschemark and sterling denominated FRNs accounted for three quarters of the total. The deutschemark sector was dominated by an issue by the Staatsbank for DM 4 billion, which took the bank's total issues since August 1990 to more than DM 40 billion. Issues of sterling FRNs increased slightly, to $2.3 billion, most representing issues by UK mortgage lenders.

Total new announcements of euronote facilities increased to $25 billion in the second quarter, and the volume of debt outstanding increased modestly, to $129.5 billion from $125.9 billion at the end of the first quarter (Table E). Within the overall figures, there was a further shift in the composition of announcements from shorter-dated eurocommercial paper (ECP) towards the establishment of longer-maturity euro medium-term note (EMTN) facilities, with the latter comprising 60% of announced euronote programmes in the first half of this year, double the share in 1990 as a whole. Many new EMTN programmes are now multi-currency, often involving Ecu. The decline in announced new ECP programmes may reflect the growing maturity of the market, which may have encouraged low rated and unrated borrowers to use domestic CP markets, where possible, or to return to bank finance.

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

Nationality of borrower	1989 Year	1990 Year	Q3	Q4	1991 Q1	Q2
United States	11.7	14.4	1.9	4.0	1.0	—
United Kingdom	6.1	8.4	3.1	1.9	2.2	8.2
Australia	12.7	10.3	0.9	2.1	2.6	4.3
Japan	10.1	6.1	1.0	1.4	2.0	2.0
Other OECD	25.7	28.2	4.9	11.7	12.2	9.9
Other	5.4	3.1	0.8	0.3	1.0	0.6
Total	**71.8**	**70.5**	**12.6**	**21.4**	**21.1**	**25.0**

(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).

In contrast to the ECP sector, net new issues of EMTNs expanded substantially in the second quarter, reflecting the growing sophistication and flexibility of the EMTN market. Some borrowers appear to be able to target relatively small EMTN issues at pockets of investor demand, achieving lower funding costs than would be possible via a larger public eurobond offering. The second quarter saw the first EMTN programme with an exchangeable domestic bond option and another programme which, as well as being index and commodity linked, carried both US private placement capability under rule 144a and approval by Japan's Ministry of Finance for issue in Japan. There was a substantial increase in EMTNs by UK borrowers in the second quarter, mainly reflecting several large programmes by UK mortgage lenders.

In the international syndicated credits market the volume of new announcements fell steeply in the second quarter to $31.2 billion, compared with $40.0 billion in the previous quarter (Table F). The decline chiefly reflected a fall of almost a quarter in borrowing by corporations to $20.5 billion, although borrowing by banks and state agencies also declined. Recessionary conditions in several of the major economies continued to depress the demand for syndicated credits, while banks' caution with regard to credit quality and balance sheet growth restrained the supply of finance. However, South-East Asian borrowers were active during the second quarter, with Korean, Indonesian and Thai borrowers accounting for about one sixth of second quarter borrowing in the syndicated credits markets.

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

	1989 Year	1990 Year	Q3	Q4	1991 Q1	Q2
Major OECD	98.6	94.0	20.0	29.6	12.0	10.6
Minor OECD	25.8	28.8	7.8	5.6	13.3	9.3
Developing countries	25.0	29.9	8.7	6.9	13.3	10.7
Eastern Europe	2.2	12.1	7.1 (b)	1.4	1.1	0.6
Other	0.1	0.3	—	0.1	0.3	—
Total	**151.7**	**165.1**	**43.6**	**43.6**	**40.0**	**31.2**

(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.
(a) Of which borrowing by East Germany accounted for $5.34 billion.

The average size of syndicated credits announced declined substantially in the second quarter, from $193 million to $118 million. In the first quarter, four syndicated credits of one billion dollars or more were announced, totalling $15.7 billion, whereas in the second only two such deals were announced, for a total of $3.5 billion. The fall in large deals probably reflects the dearth of merger and acquisition activity. The size of syndicates has fallen, partly resulting from the difficulties of negotiating with large groups.

Aggregate data from the Bank's database suggest that margins over Libor in the syndicated credits market may have fallen slightly for top rated borrowers. Indicative data suggest that average margins, weighted by the size of the deal, fell to slightly below the 0.9% prevailing in the first quarter, but this may be partly attributable to changes in the composition of borrowers.

Domestic markets

New issues and turnover

Sterling issues of debt and equity announced in the second quarter totalled £10.4 billion, taking the total for the first half of the year to £16.9 billion, only £2.6 billion below the figure for 1990 as a whole (Table G). The substantial increase in capital market issuance has occurred at a time when total sterling borrowing by UK companies has been slowing significantly and has reflected in part a desire to restructure balance sheets to reduce reliance on short-term finance, to tap institutional liquidity and to take advantage of market conditions to raise relatively cheap capital market finance (see page 346).

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	7,745	7,478	5,808	4,648	36
1990	5,316	5,613	5,542	2,322	700
Q1	1,574	1,739	1,300	1,122	350
Q2	1,431	1,630	2,312	551	60
Q3	1,354	887	930	—	290
Q4	958	1,357	1,000	650	—
1991					
Jan.	661	410	509	614	—
Feb.	195	466	249	490	—
Mar.	1,371	955	150	274	175
Q1	2,227	1,831	908	1,378	175
Apr.	1,477	1,542	325	1,001	—
May	1,802	511	565	792	—
June	1,580	390	200	—	200
Q2	4,859	2,443	1,090	1,793	200

(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.

New equity issues rose strongly in the second quarter, from an already substantial level in the first. The surge in issues occurred against the background of a fairly firm stock market. The FT-SE 100 index reached a record high of 2,555 in early April (exceeded in July), and traded for most of the period in the range 2,400–2,550, supported by anticipation of further interest rate cuts and hopes of an early end to the recession (although the market's most optimistic expectations were revised somewhat over the period). UK borrowers raised some £4.9 billion in new equity, more than double the total in the previous three months, and not far short of the total for 1990. Rights issues have predominated: in the first six months of 1991, there were over one hundred issues raising more than £6 billion, two thirds of which were

Table H
Summary of rights issues in 1991 H1

	Number of issues	Value (£ billions)
January	4	0.6
February	4	0.1
March	13	1.3
April	34	1.2
May	28	1.6
June	28	1.4
Total	**109**	**6.2**

in the second quarter (see Table H). Rights issues in the second quarter were at their highest level since the stock market fall in October 1987.

Issues of non-gilt sterling bonds rose to £5.5 billion in the second quarter as companies, some perhaps anticipating the end of the recession, took advantage of lower yields. Towards the end of the quarter, sentiment seemed to dampen somewhat, perhaps in response to a less optimistic view about the timing of economic recovery, coupled with heightening political concerns. Furthermore, currency swap opportunities reduced, so that sterling issuance became attractive mainly to those borrowers with a natural requirement for sterling funding. There may also have been a lull after some borrowers had met their immediate financing needs and while the market absorbed the new issues. An improvement in confidence with a move out of recession might increase the demand for sterling funds in the coming quarters, though much will depend on the course of domestic and international yields.

Sterling commercial paper outstanding rose to £6.4 billion at end-June, up from £5.9 billion at the end of the first quarter. Gross issues over the period totalled £12.3 billion. The steady growth in the size of the market this year is attributable, at least in part, to the move by certain companies away from bank funding. Relative to other sources of funding the sterling commercial paper market has become a more attractive option to a large number of borrowers. The range and number of companies accessing the sterling commercial paper market has continued to expand with new entrants including the recently privatised utility companies. Over the quarter the Bank has been notified of four medium-term note programmes, taking the total to fifteen.

Turnover of UK equities declined during the second quarter, with a fall in the period as a whole of 12%, to a little over £1.3 billion per day. Within the total, customer turnover accounted for some £880 million, (though it is difficult to say how this relates to firms' profitability, which depends not only on commission business but also on position taking, for example). Turnover of foreign (principally continental European) equities in London by Stock Exchange member firms also declined, albeit less severely, in the second quarter, to a little over £1.1 billion per day. It therefore appears that the much improved volumes in February and March this year were more a reflection of the euphoria surrounding the ending of the Gulf war than the beginning of a long awaited market recovery. As volume slipped back in the second quarter, spreads and touches for both the liquid and illiquid stocks, which had narrowed markedly in March, widened again and remain wider than before Iraq's invasion of Kuwait a year ago.

Average turnover in the gilt market returned to the level seen in the latter half of 1990, £3.8 billion per day. The more subdued tone of the gilt market, with longer yields edging back up, partly reflected political worries, with uncertainty about future levels of gilt issuance also being a restraining factor. Turnover was, however, supported by new gilt issues (see Table D on page 349).

Derivatives

Daily average volume on the London derivatives exchanges fell by 8% in the second quarter of 1991 following a buoyant first quarter, as volatility declined following the ending of uncertainty surrounding the Gulf crisis. Only the London Metals Exchange recorded an increase on the previous quarter (28%). Activity on LIFFE fell by 14%, despite the boost to activity in its sterling-based contracts provided by anticipated and actual base rate cuts. However, despite the quarterly fall, the underlying upward trend generally continued across the London exchanges, with volumes in the first half of 1991 10% above the same period in 1990.

The more subdued tone in the gilt market generally was reflected in gilt derivatives also. Turnover in long gilt futures on LIFFE fell back slightly to average around 19,000 contracts per day in the second quarter, down from 21,300 in the previous period. Peaks in turnover occurred on 14 and 29 May, with around 40,000 contracts traded on each day. The nominal amount of call warrants exerciseable into gilt-edged stock outstanding fell to £130 million at end-June, following the expiry of £100 million of warrants. The amount of put warrants outstanding remained at £30 million.

Turnover in the short sterling futures contract on LIFFE during the second quarter averaged 29,500 contracts per day, down from the record turnover of 40,600 in the previous quarter, and returning to around the levels seen in the middle of last year. The peak in turnover, of over 60,000 contracts, accompanied the interest rate cut on 12 April, and a similar level of turnover was seen on 17 May in reaction to the Monmouth by-election and on strong anticipation of an interest rate cut—a week before it took place. However, the general level of turnover was more subdued than in the previous period, when Gulf-related uncertainties stimulated activity in futures markets and when the most recent series of interest rate cuts began.

Table J
Nominal amount of gilt warrants outstanding
£ millions

	Call options			Put options		
	Nominal amount outstanding	New issues	Expired contracts	Nominal amount outstanding	Issues	Expired contracts
1987 Q3	780	780	—	330	330	—
Q4	780	100	100	430	100	—
1988 Q1	800	200	180	550	200	80
Q2	700	—	100	550	—	—
Q3	350	50	400	300	—	250
Q4	450	200	100	300	100	100
1989 Q1	250	—	200	100	—	200
Q2	150	—	100	—	—	100
Q3	150	—	—	—	—	—
Q4	—	—	150	—	—	—
1990 Q1	100	100	—	—	—	—
Q2	200	100	—	—	—	—
Q3	200	—	—	—	—	—
Q4	200	—	—	—	—	—
1991 Q1	230	130	100	30	30	—
Q2	130	—	100	30	—	—

Activity in LIFFE's Ecu short-term interest rate future grew by 46% in the second quarter following the introduction in April of incentive schemes to traders and the earlier re-launch of the market making scheme. Trading in LIFFE's Ecu bond future was however relatively subdued, at just under 500 lots per day. More generally, the use of Ecu hedging instruments has increased, along with activity in deposits, FRAs and bills, stimulated by Nordic moves to peg exchange rates to the Ecu.

Turnover in LIFFE's Bund future fell by 9% in the second quarter. Notwithstanding this decline, trading in LIFFE's contract continued to account for over 90% of total activity in Bund futures (there is also a contract on the Deutsche Terminbörse). In further moves which reflect increased international bond and futures trading, both LIFFE and MATIF, the Paris futures exchange, have announced intentions to introduce futures on Italian government bonds, which in nominal terms represents the third largest government bond market. In April, LIFFE launched a new version of its Japanese Government Bond Future on its Automated Pit Trading (APT) system. The contract is the first on LIFFE to trade exclusively on APT.

Actual and prospective increases in portfolio diversification throughout Europe have encouraged the introduction of derivatives which will facilitate management of exposures to the European stock markets. Thus in June, LIFFE launched a Eurotrack-100 futures contract based on the Stock Exchange's index of one hundred (non-UK) European stocks; LTOM plans to launch an option on the index shortly. There have been launches of similar though not identical contracts on the European Options Exchange and SOFFEX, the Swiss futures and options exchange; other exchanges are believed to be considering similar contracts.

In May, London FOX introduced four property futures contracts, the first exchange-traded instruments in Europe to manage property risk. Four contracts were launched on the exchange's screen-based system, on commercial and residential property values, commercial rents and mortgage rates. Trading has concentrated in the first two contracts, which in June each traded some 110 lots per day.

Settlement

In May, the Department of Trade and Industry published draft regulations to implement section 207 of the Companies Act 1989. The regulations permit securities to be held and transferred electronically without certificates in the planned

TAURUS system. The Department has asked for comments on the draft by 16 August and intends to lay a revised version before Parliament during October to seek approval in November. Companies which wish to join TAURUS would then be able to put special resolutions to their shareholders at general meetings. The Exchange expect the first few stocks to trade in dematerialised form on 11 May 1992. The system should enable settlement to be faster and more reliable. It is hoped that sufficient stocks will have been taken into the system by the end of 1992 to allow the introduction of rolling settlement and new arrangements to improve the method of making delivery against payment.

The regulations have been drafted to preserve existing rights as far as possible in the dematerialised environment. The key change is the introduction of the notion of entitlement. This is the right to specify whose name should be registered, and therefore also to transfer effective ownership. Entitlements to stock will be held only by TAURUS Account Controllers on behalf of customers, and will be transferred within the system. Entitlement will not itself confer membership of the company, which will remain with those actually registered. Account controllers will maintain records of those who have an interest in the entitlements they hold and will be responsible for notifying the names of those to be registered to registrars.

The Exchange published detailed criteria for participation in TAURUS in June. The document explains the minimum standards required of applicants in financial resources, probity and technical competence. The Exchange has also published revised indicative tariffs for the TAURUS system and amendments to the technical specifications for participants who wish to connect to the system.

By the end of the second quarter, the value of money-market instruments in the Central Moneymarkets Office (CMO) had risen to £79 billion, representing over 80% of the outstanding stock, compared with 70% at end-March. Bank certificates of deposit accounted for about half the instruments held in CMO at end-June, eligible bank bills for 29% and Treasury bills for 16%.

Regulation

Following the publication in January of the new SIB conduct of business Core Rules, the SFA and IMRO have published draft rulebooks; and both intend to produce final versions in the autumn, when FIMBRA and LAUTRO aim to produce their draft rulebooks. The SROs' new rulebooks will not come into operation until SIB has declared them to give an adequate standard of investor protection.

SIB has announced a wide-ranging review of retail regulatory arrangements. Detailed proposals relating to polarisation (the requirement that financial intermediaries should either offer wholly independent advice or be tied to a single product provider) and investor compensation are expected to emerge in the autumn. The review has already resulted in a proposal for LAUTRO firms to cap FIMBRA's contribution to the Investors' Compensation Scheme at £5 million. A limit of £19 million currently applies, and FIMBRA firms have been concerned about financing this. SIB has issued new draft regulations on the protection of client money held by investment firms and on cold calling. It has sanctioned the creation of four new types of unit trust which will give investors access to the futures and options, warrant and property markets. A tougher marketing regime will apply to these funds than to conventional unit trusts.