Financial market developments

Against a background of a general easing in interest rates in the major economies, with the principal exception of Germany, and lower long-term bond yields, a number of trends which had begun earlier in the year continued in the third quarter.

Stock markets were generally stronger...

Stock markets generally strengthened during the quarter, with a rise of about 3% in the world equity index in local currency terms (Table A). The experience of the different markets was mixed, however, with the UK and US markets reaching new highs during the quarter, while stock prices slipped back in Germany. In part this reflects the decline in interest rates in the first two economies, while those in Germany rose, but it also flows from differences in cyclical positions, with markets in the United States and the United Kingdom anticipating recovery from recession while the continental economies slow down.

Most markets recovered swiftly from the effects of the attempted Soviet coup in August, which caused declines of up to 10% in equity markets (with bigger falls for markets with closer economic links to the Soviet Union), and generally proved resilient in the face of various financial sector scandals.

Table A
International financial markets: key indicators

	1990 1 Aug: pre-invasion	1990 31 Dec.	1991 28 June	1991 30 Sept.
United Kingdom				
Equity market: FT-SE 100	2,339.0	2,143.5	2414.8	2621.7
10-year government bond yield %	11.7	11.0	10.6	9.6
3-month Treasury bill yield %	14.8	13.8	11.0	9.7
United States				
Equity market: S&P 500	355.3	330.2	371.2	387.9
10-year government bond yield %	8.3	8.1	8.2	7.5
3-month Treasury bill yield %	7.7	6.6	5.7	5.3
Canada				
Equity market: TSE Composite	3,569.0	3,256.8	3465.8	3387.9
10-year government bond yield %	10.5	10.3	10.1	9.2 (a)
3-month Treasury bill yield %	13.2	11.4	8.7	8.3
Japan				
Equity market: Nikkei	30,838.0	23,848.7 (b)	23,291.0	23,916.4
10-year government bond yield %	7.2	6.62 (b)	6.9	6.0
3-month Treasury bill yield %	7.6	7.62 (b)	7.7	6.4
Germany				
Equity market: DAX	1,892.9	1,398.2 (b)	1,622.2	1,607.0
10-year government bond yield %	8.5	9.0 (b)	8.5	8.4
3-month interbank interest rate %	8.1	9.3 (b)	9.1	9.3
France				
Equity market: CAC General	525.9	413.0	470.8	496.4
10-year government bond yield (OAT) %	9.5	10.0	9.1	8.8
3-month Treasury bill (BTF) discount rate %	9.4	9.6	9.4	9.1
Italy				
Equity market: BCI	721.9	519.4	586.2	539.1
7-year government bond yield %	14.0	14.5	13.3	13.0
3-month interbank interest rate %	11.8	13.8	11.7	11.7
World equity index				
Financial Times World Index:				
US dollar index	146.7	129.8	136.5	145.8
Local currency index	135.9	115.6	128.0	132.3

(a) 29 September.
(b) 28 December.

... with active primary markets ...

The trend towards heavier use by borrowers of capital markets rather than bank borrowing continued. Monetary growth and bank lending to companies slowed in several countries, including the United States, the United Kingdom and Japan. In international markets this showed up in continued buoyant primary market activity in bond markets, while banking activity remained subdued (see the note on page 488). In 1990, the value of syndicated credits announced closely matched the total of straight fixed-rate bond issues (Table B) but in the first three quarters of 1991 bonds outstripped syndicated credits by two to one.

The same trend towards increased use of capital market finance was also apparent in some domestic markets, notably in the United States and the United Kingdom. In these countries, companies took advantage of higher equity prices and lower interest rates to raise more funds in capital markets. This was mainly to strengthen their balance sheets and reduce the cost of borrowing. Recession in both countries meant that fund raising by companies new to the market, or for new investment, was more subdued. In the United States, the value of new stock and bond issues was only slightly below the exceptionally high level in the second quarter and the nine-month total (reportedly of over $400 billion) exceeds any previous annual total. The desire by companies to secure long-term finance may also reflect their need to refinance redemptions of existing debt. Estimates of corporate long-term debt redemptions in the United States, which vary widely, suggest that they will rise sharply, reportedly from under $20 billion in 1988 and about $35 billion last year to over $40 billion this year and peak at over $50 billion (about a third of which is junk bonds) in 1992. There are also expectations of firms (in particular utilities) using call provisions to retire higher-cost debt. Internationally, the BIS has estimated that repayments of principal could rise from about $100 billion in 1990 to a peak of over $230 billion in 1993.

... including increased participation by developing countries ...

International capital market issues by developing countries increased again in the third quarter, involving a wider range of borrowers, currencies and types of paper (including bonds, equity and ECP), together with signs of a slight lengthening in maturities. For example, the quarter saw the launch of the first Latin American Ecu and peseta bonds.

International banking developments

In the second quarter of 1991, the cross-border business of banks in the BIS reporting area fell for the second successive quarter. Both assets and liabilities fell sharply, by $108 billion and $135 billion, respectively. This reflected sharply reduced interbank activity within the BIS reporting area (claims -$126 billion, liabilities -$120 billion). The slowdown in banks' activity was widespread, but over half the fall in interbank claims related to banks in Japan, particularly with their own offices overseas, reflecting pressures on them to comply with capital adequacy requirements.

BIS-reporting banks' business with countries outside the reporting area also continued to fall in the second quarter (assets down by $9.2 billion and liabilities down by $5.7 billion). The major factor behind the fall in liabilities was a $5.4 billion withdrawal of deposits by Middle Eastern OPEC countries, to help to finance reconstruction following the Gulf War. Reporting banks' claims on Middle Eastern OPEC countries declined by $1.1 billion (despite the $4.5 billion syndicated credit completed for Saudi Arabia in May). The $4.6 billion decline in banks' claims on Latin America included a fall of $4 billion for Brazil mainly reflecting debt write-offs. Claims on Eastern Europe also contracted, by $3.1 billion, with the Soviet Union accounting for $1.8 billion of this.

In addition to the decline in interbank business, the BIS estimate of net international bank credit (the volume of funds intermediated by the BIS-reporting banks net of redepositing between banks) recorded its first ever fall, of $5 billion.

The London market

The cross-border business of banks in the United Kingdom fell back sharply in the second quarter, following depressed activity in the previous quarter. The main factor was again a considerable reduction in interbank activity. The $35 billion decrease in assets was largely to the BIS industrial area, with falls in lending to Japan of $11.6 billion, illustrating Japanese retrenchment, and to the United States of $7.8 billion. The figures also illustrate banks' cautious attitude towards lending to Eastern Europe while future developments there remain uncertain. The main drop in lending to the area was accounted for by a reduction in lending to the USSR of $0.4 billion.

Claims on offshore centres contracted, particularly on the Bahamas ($7.8 billion), the Cayman Islands ($3.0 billion) and Bahrain ($2.0 billion). Lending to oil-exporting countries rose slightly, for the first time since the fourth quarter of 1988, reflecting a turn-round in lending to Venezuela, Saudi Arabia and Iran. Lending to Mexico rose by $1.2 billion in the second quarter, underlining the country's steady return to the market.

The total cross-border liabilities of banks in the United Kingdom fell by $35.3 billion in the second quarter. This was more than accounted for by lower deposits from countries in the BIS area. Within the total there were sharp contractions in deposits from the United States ($20.9 billion), Switzerland ($9.3 billion), the Netherlands ($5.4 billion) and Luxembourg ($4.1 billion). Liabilities to countries outside the BIS area rose by $6.0 billion during the second quarter, mainly to Saudi Arabia, Kuwait, Mexico and Egypt. Cross-border liabilities to the offshore centres contracted in the second quarter of 1991, most notably to Singapore and the Cayman Islands.

Japanese-incorporated banks' share of external lending by banks in the United Kingdom increased slightly to 32.8% in the second quarter of 1991. The shares of British and American-owned banks declined slightly, each accounting for 13.2% of total external claims. The share of external lending of other overseas banks (including consortium banks) decreased marginally to 40.8%.

Cross-border business of banks in the United Kingdom

$ billions: changes exclude estimated exchange rate effects

	1990				1990		Out-standing at end-
	Year	Q2	Q3	Q4	Q1	Q2	June 91
Liabilities vis-à-vis:							
BIS industrial area	74.0	-5.3	27.8	35.2	-12.2	-41.9	682.3
of which:							
United States	*3.9*	*1.2*	*8.7*	*10.2*	*9.7*	*-20.9*	*129.4*
Japan	*-6.8*	*-9.7*	*2.4*	*-4.3*	*-2.5*	*- 1.8*	*100.9*
'Offshore' banking centres	-1.5	-4.1	1.2	0.8	-2.6	- 3.3	111.9
Sub-total	72.5	-9.4	29.0	36.0	-14.9	-45.2	794.2
Outside reporting area							
Developed countries	1.9	-0.2	2.2	-1.1	-2.9	1.3	31.1
Eastern Europe	-0.9	-0.9	0.6	0.4	-1.6	—	3.9
Oil exporters	11.9	—	5.5	5.4	-1.2	3.0	69.6
Non-oil developing countries	6.6	2.6	2.3	1.2	-1.3	1.7	55.8
of which, Latin America	*2.1*	*0.9*	*0.8*	*0.4*	*-0.3*	*0.8*	*8.4*
Sub-total	19.5	1.6	10.5	5.8	-7.0	6.0	160.4
Other (a)	8.1	2.4	3.1	-3.5	20.2	4.0	118.5
Total (b)	**100.1**	**20.9**	**42.6**	**38.3**	**-1.6**	**-35.3**	**1,073.1**
Assets (c) **vis-à-vis:**							
BIS industrial area	81.8	-2.2	43.2	17.4	-2.2	-26.4	715.5
of which:							
United States	*18.9*	*3.7*	*5.2*	*10.7*	*-13.0*	*-7.8*	*130.4*
Japan	*1.5*	*-9.6*	*13.0*	*-2.5*	*-10.6*	*-11.6*	*194.2*
'Offshore' banking centres	6.5	5.1	2.6	-1.6	-4.3	- 5.9	116.1
Sub-total	88.5	2.9	45.9	15.8	-6.5	-32.4	831.6
Outside reporting area							
Developed countries	0.2	1.4	0.1	-0.9	-0.9	- 0.5	31.5
Eastern Europe	-4.6	-1.5	-1.3	-0.9	-1.2	- 0.7	13.9
Oil exporters	-1.5	-0.7	-0.5	-0.1	-2.5	0.2	15.0
Non-oil developing countries	-3.2	-2.0	0.6	1.0	2.0	0.3	43.8
of which, Latin America	*-5.2*	*-2.5*	*-0.1*	*0.5*	*1.1*	*1.0*	*24.8*
Sub-total	- 9.1	-2.8	-1.1	-0.9	-2.7	- 0.7	104.2
Other (d)	5.2	3.6	5.9	-2.3	2.6	- 1.9	21.7
Total (b)	**84.6**	**3.7**	**50.7**	**12.6**	**-6.6**	**-35.0**	**957.5**

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

In the third quarter of 1991 UK banks' international business showed a moderate rise on both sides of the balance sheet with liabilities and claims up by $8.5 billion and $6.5 billion respectively. Within this overall moderate growth there was a sharper rundown (mainly in September) of business by Japanese banks in London (liabilities -$19.3 billion, claims -$17.7 billion). The main areas of reduced activity were with their own offices overseas and in their overall interbank activity. By contrast, the British, American and 'other overseas' banks all showed moderate growth over the quarter.

The governments of Venezuela, Argentina and South Africa, together with Brazilian public sector entities, followed Mexico and Chile back to the euromarkets, raising a total of over $3 billion during the quarter. Spreads on Latin American bond issues have narrowed noticeably this year as market confidence in some of the economies has increased. Over the same period, secondary market prices of Latin American debt have rallied strongly (though they have slipped back a little more recently) and equity markets have been generally buoyant.

... but little Eastern European involvement

The return of some developing countries to the international markets reflects the benefits of macroeconomic adjustment policies and also of market-oriented reforms in the financial sector (which have included measures to attract international investors' interest, often through privatisations). The renewed access to private capital markets for Latin American countries followed significant progress in reforms; similar reforms are being embarked upon in Eastern Europe, but private investors may remain cautious until these are well established. Uncertainty regarding developments in Eastern Europe and the Soviet Union was prominent in the third quarter. The secondary market price of Eastern European debt slipped and little extra finance was drawn from international markets in the third quarter. The National Bank of Hungary was the only Eastern European borrower to raise funds on the international bond markets, but a few syndicated loans were announced, for example by Vneshconombank in the Soviet Union (before the coup attempt).

Concerns about credit quality continued

Concern about credit quality continued, together with a cautious attitude by banks to new lending. Spreads appear to have widened, particularly for lower-quality corporate sector borrowers. In the United States, defaults on corporate debt are on course for record levels and credit downgrades continued to outnumber upgrades. Access to international markets remained difficult for lower-rated companies. The share of eurobond issues rated single A and below, which fell from 15% in 1988 to some 4% in the first half of this year, fell slightly further in the third quarter.

Concern about credit quality, together with continuing pressures on banks to restrain their lending to meet capital ratios, may also have contributed to lower volumes in international banking markets. Syndicated credit activity remained subdued in the third quarter, reflecting lower levels of mergers and acquisitions and project finance, and also further efforts by companies to rationalise their debt structures. Club deals were used in some cases to replace maturing syndicated debt, and a number of large UK companies switched existing debt from syndications to bilateral transactions.

Banks continued their restructuring efforts. The quarter saw three large mergers in the United States and further intra-European linkages (some with insurance companies). The progress banks have made in addressing problems to increase profitability has been recognised by the markets—banking sector share price indices improved in the United Kingdom and the United States by around 15% in the third quarter. However, reported results for the first half of the year were mixed, including poor figures from a number of UK banks, varying US results and profits growth in some European countries. Bank credit ratings deteriorated slightly, including downgrades for some Japanese banks.

In addition to raising new funds this year through the domestic markets, banking groups continued to raise debt capital through the euromarkets in the third quarter. The total of over $15 billion was slightly lower than the average in the first half of the year, but above that for 1990. Top-rated banks continued to predominate, but there has also been an increase in issuance by middle-rated banks this year. Funds raised during the third quarter were in a wide range of instruments, including issues of dollar preference shares, Ecu subordinated notes and the first bank issues of perpetual FRNs and variable-rate notes for about a year.

Japanese retrenchment

There were continued signs of Japanese retrenchment in international banking markets (see the note on page 488), but earlier concerns that the pressures on Japanese banks and securities firms (at a time when other international banks were under pressure) would lead to a contraction in international financing activity across the board appear to have been overstated, though interbank activity, including between Japanese branches in London, has decreased considerably. Syndicated lending by Japanese banks has shown a sharp decline, perhaps faster than for syndicated credits more generally. Japanese securities firms are reported to have continued to be active in the US Treasury, eurobond and ECP markets. Overall, Japanese investors have remained net purchasers of foreign bonds and equities this year. Moreover, some Japanese banks and securities firms have announced extensions in their international securities and derivatives operations.

The revelations about improper trading practices by securities firms appear to have dampened activity in Japan in the third quarter. Credit ratings of Japanese securities firms were revised down after they issued gloomy forecasts for half-year profits, which included the first expected loss by any major Japanese house since the 1960s, and following the setting of penalties for the big four securities houses for regulatory breaches. Overseas firms meanwhile increased their market share of turnover in Tokyo Stock Exchange first section stocks, to nearly 20% at end-June, largely owing to a revival in foreign investment in Japan.

New debt issues and turnover in international markets

International bond markets remained fairly buoyant ...

Overall financing activity in the international capital markets fell a little in the third quarter, but from high levels, with the

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

	1989	1990		1991		
	Year	Year	Q4	Q1	Q2	Q3
Fixed-rate bonds						
Straights	150.0	172.1	49.8	81.1	60.4	59.9
Equity related	85.1	33.0	6.5	7.4	19.9	11.8
of which:						
Warrants	*69.5*	*22.6*	*4.8*	*5.6*	*13.1*	*9.6*
Convertibles	*15.6*	*10.4*	*1.7*	*1.8*	*6.8*	*2.2*
Bonds with non-equity warrants (currency, gold, debt)	0.5	0.1	—	0.1	—	0.2
Total	**235.6**	**205.2**	**56.3**	**88.6**	**80.3**	**71.9**
Floating-rate notes	27.1	57.6	7.3	6.2	6.5	4.5
Euronote facilities	71.8	70.5	21.4	21.1	26.3	15.3
Syndicated credits	151.7	165.0	43.4	40.1	31.5	29.0
Total	**486.2**	**498.3**	**128.4**	**156.0**	**144.6**	**120.7**

(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.

total for the first nine months of 1991 being 14% higher than a year earlier. Secondary market turnover rose again, against the background of declines in market rates (see the chart). The decline in total international financing activity in the third quarter reflected reductions in three main areas: equity-related debt, medium-term note facilities and syndicated credits. Fixed-rate bonds (which accounted for about half of all international financing activity) and short-term note facilities held up over the quarter.

The dollar sector accounted for 35% of total fixed-rate bond issues (Table C), broadly in line with recent periods. International demand for dollar assets held up despite a weaker dollar, perhaps being sustained by the continued steepness of the US yield curve and expectations of some further decline in rates. Borrowers (notably governments and supranationals) have been attracted by the liquidity of the dollar sector, but there has been a developing tendency for larger issuers to seek as wide an investor base as possible, and for increased linkages between euro and domestic markets: of the seven further global bonds launched during the quarter, three were in US dollars, including a large credit card backed issue. Two Canadian utilities launched Canadian dollar global bonds with maturities of 30 years which, along with the 40-year issue earlier this year, were among the longest ever issued in the international markets. Global issuance also extended to other sectors (and to medium-term notes): the first two issues in the Australian dollar market were announced during the third quarter.

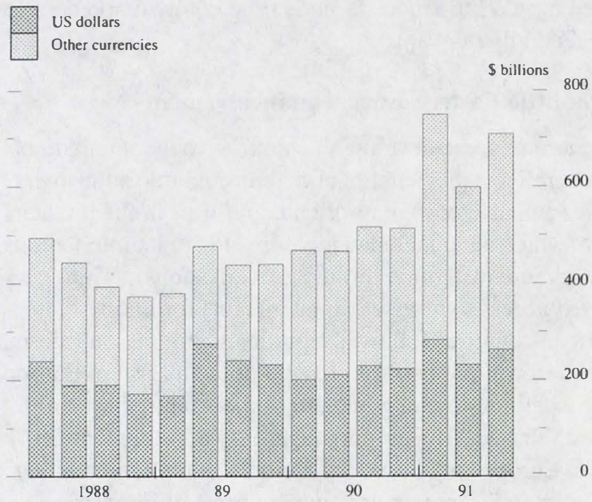
Table C
Currency composition of fixed-rate bond issues(a)
Percentages of total issues announced

	1990	1991		
Currency denomination	Year	Q1	Q2	Q3
US dollars	35	30	37	35
Swiss francs	12	7	7	6
Yen	15	11	11	12
Deutschemarks	5	3	7	4
Sterling	6	7	9	6
Australian dollars	4	2	1	2
Canadian dollars	3	9	7	10
Ecu	9	19	8	10
French francs	4	4	4	7
Other	7	8	9	8

(a) Including equity-related issues.

The share of the Ecu in international fixed-rate bond issues edged up, but was half the exceptionally high level of the first quarter. The Canadian dollar's share increased to 10%, reflecting continued heavy borrowing by the provinces and utilities. The increase in French franc bonds reflected fund-raising by French banks. International new issues of

Straight eurobonds: secondary market turnover



Source: AIBD.

sterling bonds eased to $4.6 billion (still a high level), despite strong demand stemming from lower yields. Within the total, corporate sector issues remained relatively buoyant, with several at very long maturities (15–25 years). There were further signs of growth in developing European bond markets such as the lira, Swedish krona and the peseta, with lira and peseta activity benefiting from further market liberalisation.

Foreign currency bond issues announced by UK private sector borrowers totalled $3.8 billion in the third quarter, up from $3.3 billion in the second quarter and continuing the upward trend begun in the third quarter last year. Twenty-seven issues were announced, the largest being a fixed-rate issue by Abbey National Treasury, while Grand Metropolitan issued the largest ever Yankee bond ($900 million) by a UK borrower. Borrowing by foreign subsidiaries of UK companies may have offset the effects of recession on UK issuance, with overseas subsidiaries accounting for more than 50% of borrowing in the third quarter, compared with an average of 25% in 1990.

Borrowing by supranationals rose to 13% of total fixed-rate paper (Table D). The EIB and the World Bank (which returned to issuing euro-medium-term notes after a three year absence), remained prominent borrowers in the euromarkets. In addition, the EBRD issued its first eurobond, denominated in Ecu.

. . . but there were fewer equity-related issues . . .

Equity-related bond issues, which continued to be dominated by Japanese borrowers, fell back sharply from the high level

Table D
Fixed-rate bond issues by country of issuer(a)
Percentage by value of total issues announced

Country of issuer	1990 Year	1991 Q1	Q2	Q3
United States	9	5	12	6
United Kingdom	7	11	9	8
Japan	24	17	25	29
Germany	4	3	4	6
France	9	6	10	10
Canada	6	12	9	9
Australia	3	1	1	2
Italy	4	8	2	1
International institutions	14	15	7	13
Other	20	22	21	16

(a) Including equity-related issues.

in the second quarter, but were well above the average for 1990. New issues eased after the attempted Soviet coup partly because higher coupons (by up to a percentage point) had to be offered on bonds to offset the diminished attraction of the underlying equities. A number of Japanese borrowers apparently switched from the equity-related market into the straight fixed-rate yen sector as the yen cost of equity-warrant deals reached historically high levels compared with fixed-rate yen debt. Oversupply also contributed to lower volumes of new equity-related issues and was reflected in continuing encouragement by the Japanese authorities for voluntary restraint on issuance. Liquidity in the euro-yen sector was boosted by an inaugural issue by the Japanese Development Bank (¥ 120 billion) which was the first euro-yen issue to carry a sovereign guarantee from Japan.

... and fewer issues of FRNs (with the exception of sterling) ...

Floating-rate note issues declined to $4.5 billion, the lowest quarterly level since the start of 1989. Demand was subdued by expectations of lower interest rates, credit concerns over financial institutions and continuing problems of illiquidity as turnover remained subdued. The sterling sector remained relatively buoyant, with issues by UK financial institutions of $1.7 billion equivalent. This included four new mortgage-backed issues which were structured with senior and subordinated tranches to gain top ratings, as an alternative to obtaining insurance company guarantees. The credit ratings of existing mortgage-backed bonds supported by insurance policies have come under pressure. Floating-rate issues by UK building societies increased, including the first two such issues denominated in Ecu.

... while announced new euronote facilities fell ...

Announced new euronote facilities (Table E) fell to $15 billion, the lowest level for a year, reflecting the large total of unused facilities and, perhaps, the attractiveness of other debt. Despite the fall in new facilities, total euro-medium-term notes outstanding increased by nearly $5 billion (18%) during the quarter to over $31 billion, bringing the increase so far this year to nearly $10 billion. Most are straight fixed-rate issues, but increasing numbers have more complicated interest rate structures and a few include derivatives features. Multi-currency facilities have accounted for an increasing proportion of programmes, rising to around 35% from 17% last year. US dollar issues accounted for under 60% of outstandings at the end of September, falling from 83% at the start of 1990. This was offset by increased issuance in Italian lira, sterling, yen, Australian dollars and the Ecu. The third quarter also saw the first issues in a number of Scandinavian currencies. Announced new ECP facilities increased slightly, matching

Table E
Announced euronote facilities (a)
$ billions

Nationality of borrower	1989 Year	1990 Year	Q4	1991 Q1	Q2	Q3
United States	11.7	14.4	4.0	1.0	—	2.4
United Kingdom	6.1	8.4	1.9	2.2	8.4	2.1
Australia	12.7	10.3	2.1	2.6	4.1	1.0
Japan	10.1	6.1	1.4	2.0	2.0	2.5
Other OECD	25.8	28.3	11.8	12.3	10.0	4.8
Other	5.4	3.0	0.2	1.0	1.8	2.5
Total	**71.8**	**70.5**	**21.4**	**21.1**	**26.3**	**15.3**

(a) Includes all facilities 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).

last year's levels. The largest issuers by nationality were Canada, Japan and the United Kingdom, while Australian and Canadian dollar facilities accounted for an unusually high proportion (45%) of the total. Mexican companies also issued paper. The value of ECP outstanding changed little during the quarter. There were further signs of deepening in domestic markets, such as the launch of the second domestic French franc facility by an overseas company and an expansion in the domestic German programme of the Treuhandanstalt.

... and there was less syndicated credits activity

The decline in syndicated credits activity reflected in part a fall in Italian borrowing from nearly $4 billion to $0.2 billion (Table F). International banks avoided the Italian market after losses on loans to a state-run Italian agricultural co-operative which ran into financial difficulties. Banks appear to have expected the entity to be government guaranteed. Elsewhere, borrowings also remained generally subdued. One large deal for a tobacco and foods company helped to boost US activity (up by nearly $3 billion) and Indonesian borrowings remained high ($2.7 billion) despite government action to stem public sector foreign borrowing, and therefore external debt, by establishing a committee to prioritise and allocate credit. Kuwait raised just over $1 billion for trade finance, ahead of expected major fund-raising to finance reconstruction.

Table F
Announced eurocurrency syndicated credits(a)
$ billions

	1989 Year	1990 Year	Q4	1991 Q1	Q2	Q3
Major OECD	98.6	94.0	29.6	12.0	10.7	12.2
Minor OECD	25.8	28.8	5.6	13.3	9.3	5.1
Developing countries	25.0	29.8	6.7	13.4	10.9	10.1
Eastern Europe	2.2	12.1	1.4	1.1	0.6	1.4
Other	0.1	0.3	0.1	0.3	—	0.2
Total	**151.7**	**165.0**	**43.4**	**40.1**	**31.5**	**29.0**

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

Average margins over LIBOR for syndicated credits increased slightly over the quarter. This reflects an increase in spreads for lower-rated borrowers and also relatively fewer top-rated borrowers (who are the most likely to have switched to capital markets for finance). Developing countries continued to come to the market, generally for relatively small loans, which kept the average size of credits at a low level.

Domestic markets

New issues and turnover

Sterling new issues continued at high levels

Sterling issues of debt and equity announced in the third quarter, though more subdued than in the second, still remained at high levels: issues in the first nine months of the year, almost £25 billion, exceeded the total of some £19 billion for the whole of last year (Table G). The decline in sterling capital issues to £7.6 billion in the third quarter, down from the very high £10.6 billion in the second quarter, may partly be ascribed to seasonal factors, but also reflects a reduction in ICCs' total borrowing.

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
1989	7,745	7,478	5,809	4,648	36
1990	5,316	5,614	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					
Q1	2,227	1,831	908	1,378	175
Apr.	1,514	1,542	325	1,001	—
May	1,815	511	565	792	—
June	1,600	415	275	—	200
Q2	4,929	2,468	1,165	1,793	200
July	362	679	200	210	20
Aug.	1,318	616	305	255	—
Sept.	1,900	668	445	600	—
Q3	3,580	1,963	950	1,065	20

(a) Further details can be found in the Bank's monthly Capital Issues Press Notice.
(b) Including issues by overseas financial 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 privatisation) are excluded.

There were fewer equity issues during the quarter, owing in part to uncertainties following the attempted coup in the Soviet Union in August and in part to seasonal factors. Rights issues have dominated issues of equity this year—accounting for about 80% of the total—as companies continue their balance sheet restructuring. Issues of non-gilt sterling bonds eased back in line with share issues to £4.0 billion in the third quarter, from a revised £5.6 billion in the second. Companies' heavy use of capital market issues may have contributed to a decline in liquidity of the main investing institutions, though it is unclear what effect this might have on their willingness to take up further issues as the economy moves out of recession.

Sterling commercial paper outstanding rose to £7 billion at end-September from £6.4 billion at the end of the second quarter. A similar seasonal pattern was seen last year, although this year the volume of new issues was lower. The Bank has been notified of six MTN programmes over the quarter, taking the total to twenty-five (including four previously unnotified programmes).

Gilt trading rallied during the quarter ...

Average turnover in the gilt market, £4.6 billion per day, was the highest since the third quarter of 1988, and compared with £3.8 billion per day in the second quarter. The pick-up in turnover was stimulated by new issues and by declines in gilt yields. Activity slowed towards the end of the quarter as a result of uncertainty over the timing of the election, but further new issues were still well received by the market.

... and equity turnover increased ...

Turnover of domestic equities rose by 9% in the third quarter to some £1.4 billion per day, with customer business constituting about two thirds of the total. The increase helped to improve the liquidity of the FTSE 100 stocks. The touch (the difference between the best bid and best offer posted by market makers) narrowed from 1.07% to about 0.96%. However, liquidity for second and third line stocks remained poor, with touches around 7% and 9% respectively. The increase in turnover of domestic equities was partially offset by a 9% decline in trading of foreign (principally continental European) equities by London Stock Exchange member firms, to just over £1 billion daily during the period. London appears on the whole to be maintaining its market share relative to the home exchanges, despite competitively motivated reforms on many European domestic exchanges. The abolition of the German turnover tax at the start of the year may have caused a drop in the trading of German equities in London, but the introduction of IBIS II does not so far appear to have had any effect on the relative sizes of the German and SEAQ International markets. The French authorities have yet to decide whether to follow recommendations in the de la Serre report on the Paris Bourse to move towards a block trading system and abolish turnover tax. London currently has a 30% share of trading in French equities.

... while prices reached record highs

Prices in the UK equity market reached record levels in the third quarter as the market looked forward to economic recovery: the FTSE 100 reached a peak of 2676.9 on 2 September. The index had earlier dropped some 80 points (3%) in response to the attempted Soviet coup on 19 August, but recovered quickly when it became apparent that the coup was going to fail. On-exchange equity derivatives trading increased further during the quarter, and appears to have stabilised for the time being at around 95% of the underlying cash market. This still contrasts, however, with the United States, where equity derivatives activity considerably outweighs cash market turnover.

Linkages between banks, building societies and insurance companies

There were further examples during the third quarter of increased links between banking, investment services and life assurance businesses. Abbey National announced a proposal to acquire Scottish Mutual, a life assurance company, following the route taken by Britannia Building Society two years ago when it bought FS Assurance. National Westminster Bank is establishing a new subsidiary in a joint venture with Clerical Medical, another mutual insurer. Almost all the major UK banks and building societies have now diversified into investment-linked life assurance products, through wholly-owned subsidiaries, joint ventures or simply tied agency agreements with leading life offices (see the table). One motivation of such linkages is to provide the banks with what is at present a more rapidly growing and secure source of earnings than traditional banking activities. Moreover, demand for life assurance and personal pensions products may be boosted in coming years by the liberalisation of EC insurance markets and by demographic trends in several European countries. For insurance companies, the main advantage of the link-ups is that they provide an established customer base and distribution network, which may help to increase productivity and enable insurance-linked products to be sold more cheaply. Both partners may be able to benefit from potential economies of scale and greater efficiency through the joint use of marketing networks to sell complementary products, including unit trusts, PEPs and personal pensions.

Some examples of linkages between UK banks, building societies and insurance companies

Bank	**Insurance company**	**Nature of link** (a)
Abbey National	Scottish Mutual	Wholly owned subsidiary following demutualisation.
	Friends Provident	Tied agent (until 1 January 1993).
Bank of Scotland	Standard Life	Tied agent. SL owns 34% of BS.
Barclays Bank	Barclays Life	Wholly owned subsidiary.
Hambros	GRE	Hambro Countrywide. A joint venture, 100% owned by Hambros Bank (in which GRE has 21% stake).
Lloyd's Bank	Abbey Life	59% owned by Lloyd's.
	Black Horse Life	Wholly owned subsidiary.
Midland Bank	Commercial Union	Midland Life. A joint venture, 65% owned by Midland Bank.
National Westminster Bank	Clerical Medical	NW Life. A joint venture, 92.5% owned by NW Bank.
Royal Bank of Scotland	Scottish Equitable	Royal Scottish Life. A joint venture, 51% owned by RBS.
Building society		
Alliance & Leicester	Scottish Amicable	Tied agent.
Bristol & West	Eagle Star	Tied agent.
Britannia	Britannia Life	Wholly owned subsidiary following demutualisation of FS Assurance and acquisition of Crusader.
Cheltenham & Gloucester	Legal and General	Tied agent.
Halifax	Standard Life	Tied agent and Halifax Standard Trust Management, a joint venture offering unit trusts and PEPs, owned equally.
Leeds Permanent	Norwich Union	Tied agent.
Nationwide Anglia	GRE	Tied agent.
Woolwich	Sun Alliance	Woolwich Life. A joint venture, 51% owned by Woolwich.

(a) A 'tied agency' agreement involves the bank or building society acting as a 'tied agent', or approved representative, of the insurance company.

Derivatives

Volumes were boosted by the attempted Soviet coup

Activity in the usually quiet summer period was boosted by market reaction to the attempted Soviet coup in August. Volumes in the derivatives markets were about 3% higher than in the second quarter, and also 3% up on the same period last year, when activity was high because of the Gulf crisis. Turnover in the oil market went 15% above the second quarter figure, benefiting from volatility in underlying oil prices, although it was well below the unusually high levels of last year. Activity on the LME fell in the third quarter owing to seasonal factors, but the underlying upward trend continued, with trading nearly 15% up on the third quarter of 1990.

The oil market and most government bond derivative markets reacted strongly to the attempted Soviet coup. A record daily turnover was achieved on the IPE on 19 August. LIFFE's government bond contracts were particularly active, with the Bund future achieving record turnover as investors sold deutschemark assets. The non-oil commodity markets were relatively unaffected.

Turnover in long gilt futures on LIFFE rose from subdued second quarter levels to average 22,700 contracts per day, in line with the stronger tone in the cash market. Peaks in turnover were reached in early July as investors switched into gilts from French and German bonds on speculation of a further cut in UK base rates and again when the 1/2% cut came on 12 July. Turnover rose again during the attempted Soviet coup in August although the market was much less affected than those of the Bund and US Treasury bond contracts. Further high levels of turnover were reached ahead of the RPI release on 13 September and during the following weeks as attention turned to domestic politics ahead of the conference season. High turnover in September (which averaged 25,000 contracts per day) raised quarterly volume to above the high level of the third quarter of last year after the invasion of Kuwait. The nominal amount of outstanding call warrants exercisable into gilt-edged stock remained unchanged at the end of September following a very quiet quarter. The amount of outstanding put warrants also remained unchanged at £30 million (Table H).

The short sterling futures contract on LIFFE traded quietly during the third quarter, in line with the cash market.

Table H
Nominal amount of gilt warrants outstanding
£ millions

		Call options			Put options		
		Nominal amounts outstanding	New issues	Expired contracts	Nominal amounts outstanding	New 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	—	—
	Q3	130	—	—	30	—	—

Turnover was seasonally low during July and August, rising again through September to give an average of 25,200 contracts per day over the quarter. Both turnover and price rose at the time of the attempted Soviet coup and again when base rates were cut to 10½% on 4 September.

LIFFE widened its product range . . .

LIFFE has continued to expand its product range, with a focus on Europeanisation. On 19 September, LIFFE launched an Italian Government Bond future. Early performance was strong, turnover averaging 10,800 contracts per day to the end of September. LIFFE began trading the future on its out-of-hours Automated Pit Trading system from 30 September and announced plans to launch an option on the future. The Paris exchange MATIF launched a similar futures contract on 5 September, which in notional value is half the size of LIFFE's: trade averaged some 6,500 contracts per day to the end of that month. LIFFE is now one of the world's most diversified exchanges, in terms of the range of contracts which make a significant contribution to volume.

As part of its programme to boost options volumes, on 12 August LIFFE introduced a new Autoquote facility providing indicative prices for its Bund option. It is intended that the facility will also be used for other options contracts, including the new option on the Italian bond future. Turnover in LIFFE's options was 28% higher during the first nine months of 1991 than in the same period last year.

. . . and continued preparations for its merger with LTOM

Preparations continue for the LIFFE/LTOM merger, scheduled to take place in the early part of next year. LIFFE intends to relocate to new premises in mid-December, and will be joined by LTOM shortly thereafter. In the first joint contract venture between the exchanges, on 23 September LTOM launched a Eurotrack option, based on the Stock Exchange's index of 100 European (excluding UK) stocks. The option is designed to complement LIFFE's future on the same index, launched at the end of June. Both contracts are aimed at fund managers wishing to hedge pan-European equity portfolios.

Regulation

Polarisation is to continue

The SIB's review of retail regulatory arrangements has come out in favour of continuing the existing polarisation regime, under which financial intermediaries are required either to offer wholly independent advice or to be tied to a single product provider. Practitioners' responses on whether the principle should be relaxed to allow tying to more than one provider ('multi-tying') were mainly consistent with the view that the value of independent advice justified regulatory support and that multi-tying would further confuse consumers over the status of investment advisors, as well as creating regulatory difficulties.

The SIB has commissioned an investigation into the current role of SROs, which will consider whether it is appropriate to establish a new organisation to supervise pooled retail investments such as unit trusts. The review is expected to be completed early in 1992. The final version of IMRO's rulebook has been published and will come into effect on 30 November. This is the first in the series of new SRO rulebooks to be finalised.

A new Memorandum of Understanding was signed between the United Kingdom and the United States in Washington providing for consultation and co-operation on a wide range of securities and futures issues. The agreement supersedes an earlier Memorandum signed in 1986 and expands the forms of mutual assistance that can be given by the authorities to cover virtually all types of cases that could arise under the securities and futures laws of both jurisdictions.

Securities regulators, meeting in Washington for the IOSCO (International Organisation of Securities Commissions) conference, agreed on an approach to setting capital adequacy standards for market risks that would provide a basis for convergence on capital adequacy rules between the banking and securities regulators. The way now seems clear for a joint meeting of IOSCO and the Basle Committee of banking supervisors. The London Stock Exchange has amended its constitution by unanimous vote, creating a new smaller governing Board composed of 25 representatives from member firms, banking, industry and investment institutions.

Settlement

Moves have been suggested to improve Ecu clearing and settlement

Governors of EC central banks have endorsed the need for measures to address structural and operational deficiencies in the Ecu clearing and settlement system. The Bank has put forward two proposals for liquidity facilities to assist smooth Ecu clearing.

Under the two facilities, participating Ecu clearing banks will be able to use a variety of different instruments as collateral for overnight Ecu loans. Under the first facility, the Bank will be prepared to lend to Ecu clearing banks against the security of either Ecu-denominated Treasury bills and bonds issued by HMG (held in Euroclear or Cedel), or a range of sterling-denominated instruments (Treasury bills, local authority bills and eligible bank bills) held in CMO. The Bank will act as intermediary between banks with surplus Ecu funds and banks in need of Ecu loans, where the latter have sufficient holdings of collateral. Under the second facility, Ecu clearing banks will be invited to place Ecu term deposits with the Bank, which they would then be able to pledge as collateral for borrowing from banks with surplus Ecu funds. The Bank has emphasised that these proposed facilities are interim measures, pending the design and implementation of long-term steps to effect structural improvements in the Ecu clearing.

The Stock Exchange has announced that the May 1992 target for the introduction of TAURUS will not be met. It has issued a revised timetable, based on the development requirements both of the Exchange and of potential participants, and now envisages live implementation of TAURUS in April 1993. The consultation period on the draft regulations to implement section 207 of the Companies Act 1989, which will permit the introduction of TAURUS, has ended. The DTI is considering the responses it has received and is expected to lay a revised version before Parliament shortly.