

Developments in international banking and capital markets in 1991

This article assesses developments in international banking activity, as shown by BIS statistics, and in the bond, euronote and syndicated credit sectors of the international capital markets, and relates these to wider economic and financial developments.

- Overall, international financing activity fell sharply in 1991.
- Borrowing in the international bond markets grew rapidly, but there was a net repayment of international bank lending—concentrated in the interbank market—as banks continued to assess credit risks cautiously in the light of new capital adequacy requirements.
- On the demand side, the world economic slowdown and companies' caution about increasing their indebtedness also contributed to the relatively modest level of international financing flows overall.
- A resumption of issuance in the international bond markets by some Latin American countries has been a feature of the past couple of years.

Overview

Total net international financing fell from \$572 billion in 1990 to \$265 billion in 1991 (Table A). The most striking feature, however, was the contrast between the strong advance in borrowing activity in the international bond markets and a contraction of activity in international banking markets.

Table A
Estimated net lending in international markets 1987–91

\$ billions: banking flows adjusted to exclude estimated exchange rate effect

	1987	1988	1989	1990	1991
1 Gross international bank lending	760	511	807	714	-102
2 Net international bank lending	300	260	410	465	85
3 Gross new bond issues(a)	176	227	267	263	329
4 Less redemptions and repurchases	71	79	90	109	148
5 Net new bond issues	105	148	177	154	181
6 Net new euronote placements	23	20	7	32	34
7 Total international financing (2+5+6)	428	428	594	651	300
8 Less double counting	53	67	76	79	35
9 Total net international financing	375	361	518	572	265

Source: BIS, Bank of England and Euroclear.

(a) On a completion basis.

The sharp expansion in international capital market activity was concentrated in the fixed-rate bond market, where borrowings rose by 53%. Equity-related bond issuance increased, but only to around half its (peak) 1989 level as the weakness of the Japanese equity market dampened investor demand for such instruments. The volume of FRN issues fell to its lowest level since 1987 because of credit quality and interest rate concerns.

Investor interest in the fixed-rate bond market was stimulated by actual and prospective capital gains, as yields fell in all the main currency sectors, and by an increased availability of highly-rated liquid issues. Borrowers were attracted by the possibility of locking into lower yields. Once the Gulf War was over, activity rebounded strongly during the first quarter and the market absorbed some very large issues by sovereign and supranational borrowers. Tight financing conditions in some domestic markets (eg Japan) and in the international market for bank credit also stimulated primary bond market volumes.

The net volume of funds raised in the international bond markets grew less sharply than gross issuance in 1991 and was only 4% higher than its previous peak level in 1989. This pattern reflected increased capital repayments on outstanding international bond issues, together with the boost given to issuance by issuers' refinancing requirements and investors' appetite to reinvest redemption flows.

A feature of the euronote market in 1991 was the growing popularity, with both issuers and investors, of euro-medium-term notes (EMTNs), because of the flexibility of timing, amount and currency of issuance that an EMTN programme offers.

In contrast to the overall strength of international capital market activity, there was a net repayment of international bank lending of \$102 billion, or 1% of the outstanding stock, in 1991. There was a pronounced decline in activity in the interbank market, a market segment with thin margins which appears to have been most affected by banks' increased emphasis on improving their risk-adjusted return on capital.

The cutback was particularly concentrated among Japanese banks. The increasing use of derivatives to manage risks may also have led the banks to use the interbank market less for this purpose. After removing the effects of redepositing within the interbank market, net international bank credit⁽¹⁾ fell sharply from \$465 billion in 1990 to \$85 billion in 1991; and new borrowing in the syndicated credit segment of the market⁽²⁾ fell by 16% to its lowest level since 1988.

Both demand and supply influences contributed to the weakness in international credit market activity in 1991. On the demand side, the world economy slowed and the short-term prospects for recovery were uncertain; companies were cautious about incurring increased indebtedness at a time of renewed awareness of the risks and the possible implications of downgrading or being put on 'credit watch' by the rating agencies; and bilateral lending arrangements between banks and companies became more attractive at a time when the difficulties of restructuring the borrowings of a troubled company from a large syndicate of banks became more apparent. Lastly, the demand for merger and acquisition finance, which had contributed to the growth of the syndicated credit market in the late 1980s, was limited.

On the supply side, international banks' continuing caution about lending to all but the highest quality borrowers reduced the level of intermediation through international banking markets. As in 1990, the major international banks continued to concentrate on the quality of their loan portfolios, and they were cautious about increasing their exposures, particularly where the risk-adjusted returns did not match capital costs. These trends were particularly evident among Japanese and American banks. Tighter credit conditions were reflected in: an increase in spreads to their highest level since the early 1980s; increased tiering of lending terms between higher and lower-rated borrowers as the year progressed; a tightening of covenants on new credits; and a shortening of maturities. Banks continued to lend on a significant scale to highly-rated borrowers. Financial restructurings by some highly-rated corporations, and a demand for reconstruction finance in the Middle East, contributed to a modest recovery in syndicated credit activity during the second half of 1991.

The disciplines placed on internationally active banks by the BIS capital adequacy guidelines led to increased fund-raising of equity and subordinated debt in a variety of capital markets (public and private, domestic and international) by banks attempting to raise their Tier 1 and Tier 2 capital. A number of well-capitalised European banks also raised capital, either for precautionary reasons (in the light of the possibility of future bad debts) or to finance expansion (eg by German banks eastwards). Last year also saw continuing efforts by banks to reduce capital requirements by transferring assets, such as mortgages and consumer loans, to special-purpose vehicles which issue asset-backed securities.

Asset diversification by international investment institutions contributed to the continued development in 1991 of some smaller sectors of the international capital markets, notably in continental Europe. As domestic capital markets have been deregulated, they have become more able to compete with international markets. For example, last year saw a strong expansion of the domestic French franc and newly-established deutschemark commercial paper (CP) markets, into which domestic borrowers could issue paper relatively easily due to name-recognition by investors. There was also a further development in 1991 of the global bond structure. Under this structure, bonds can be simultaneously issued in different sectors of the 'global' bond market and arrangements exist for the transfer of bonds between, say, euromarket and national depositories. This greater flexibility has enhanced the worldwide marketability and liquidity of these bonds.

Issues by non-OECD borrowers increased sharply last year (see the box on page 197). In particular, there was a strong expansion of borrowing by an increasing number of Latin American countries through a widening range of instruments. Argentina and Brazil returned to the international bond market in 1991 to join Mexico and Venezuela, both of which had re-entered the market in 1990. This trend has reflected growing confidence among international investors with a natural demand for high-yielding securities in the adjustment strategies that several of these countries have adopted, or are expected to adopt. It is also believed that these issues have been purchased by local investors on a substantial scale, thus contributing to a repatriation of flight capital.

International banking developments

During 1991 there was a net repayment of international bank lending of \$102 billion, or 1% of the outstanding stock, after growth of 10% in 1990 (see Table B). Interbank lending within the BIS reporting area fell by 4%, and the growth in lending to non-banks within the BIS reporting area slowed

Table B
Growth of international bank lending

\$ billions; *percentage changes in italics*

	Exchange rate adjusted flows					Stock	
	1987	1988	1989	1990	1991	1991	
Inside reporting area:							
Interbank	558	336	564	396	-205	4,742	-4.1
Non-bank	178	160	230	284	104	1,851	6.0
Outside reporting area	11	14	-2	-12	8	756	1.1
Unallocated by country	12	1	15	45	-9	148	-5.7
Gross lending	760	511	807	714	-102	7,497	-1.3
<i>Less: Redepositing of funds in the inside area interbank market</i>	460	251	397	249	-187	3,887	-4.6
Net international bank credit	300	260	410	465	85	3,610	2.4
<i>Memorandum items:</i>							
Cross-border lending	597	436	685	608	-56	6,240	-0.9
Local FOREX lending	163	75	122	106	-46	1,257	-3.5

Source: BIS (from data reported to the BIS by banks in the BIS reporting area, ie G10 countries, seven other industrialised countries and seven offshore centres).

(1) Net international bank credit is the volume of funds intermediated by the BIS-reporting banks, net of redepositing between banks.

(2) Data on syndicated credit volumes are based on public announcements of new credits, in contrast with the balance sheet data underlying the BIS data on international banking activity.

sharply to 6%. After removing the effects of redepositing (see Table B) within the interbank market, the growth in the volume of funds intermediated by BIS-area banks (net international bank credit) fell back sharply in 1991 to \$85 billion, and recorded its first ever quarterly fall in the second quarter.

The interbank market within the BIS reporting area

Total interbank lending fell last year by 4% after growth of 7% in 1990 (see Table C).

Table C
Inside area international interbank market

\$ billions; percentage changes in italics

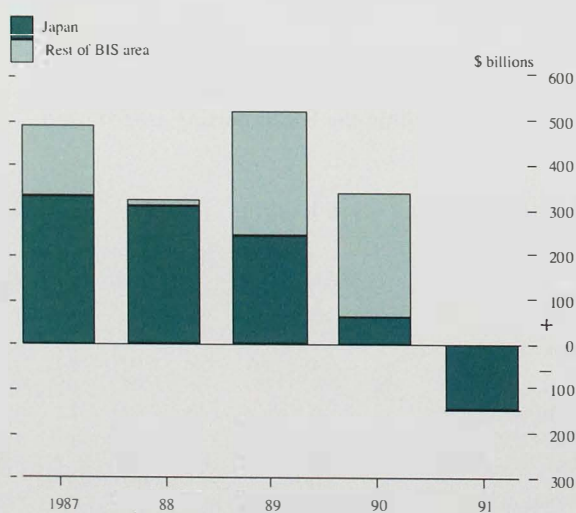
	Exchange rate adjusted flows					Stocks	
	1987	1988	1989	1990	1991	1991	
Cross-border lending involving banks in:							
Japan	334	312	244	69	-145	1,457	-9.1
United States (a)	74	13	116	51	12	815	1.5
Europe only	61	36	122	178	34	1,387	2.5
Other	28	-22	43	51	-45	495	-8.3
Cross-border lending	496	329	525	349	-145	4,153	-3.4
Local foreign currency interbank lending	62	7	39	47	-60	589	-9.2
Total	558	336	564	396	-205	4,742	-4.1

Source: BIS.

(a) Excluding business with banks in Japan, which is included under Japan.

This fall was mainly attributable to the sharp downturn in the cross-border activity of banks located in Japan (see Chart 1), largely during the first half of the year. Business between banks located in Japan and other reporting countries fell by 9% in 1991 compared with a rise of 6% in 1990.

Chart 1
Cross-border interbank lending



The reduction in interbank activity by banks in Japan reflected efforts to reduce risk assets to meet capital adequacy requirements. Concerns over the credit rating of some major international banks may also have led to some reduction in exposures.

The same pressures affected interbank activity elsewhere—business involving banks located in the United States grew

by only 1% while business between banks in Europe, which grew rapidly in 1989 and 1990, rose by only 3%. The increasing use of derivatives may mean banks are using the interbank market less for managing risk (eg for hedging interest rate risk).

Net international bank credit

Alongside the sharp decline of redepositing within the interbank market in 1991 (see Table B), the use of the interbank market as a funding source for domestic lending also declined (by \$18 billion) in contrast to earlier years (see Table D). Such funding can arise in two ways: (i) by switching foreign currency borrowing into domestic currency for on-lending; and (ii) by borrowing domestic currency abroad for on-lending. The extent of this funding as estimated by the BIS is shown in Table D. Banks in Japan repaid about \$60 billion of yen liabilities to foreign banks and were largely responsible for the fall in domestic currency borrowing abroad in 1991. This was partly offset, however, by banks in France, who increased their French franc liabilities to foreign banks by nearly \$20 billion.

Table D
Net international bank credit

\$ billions; percentage changes in italics

	Exchange rate adjusted flows					Stocks	
	1987	1988	1989	1990	1991	1991	
Use of interbank funds:							
Inward switching	39	44	62	54	17	367	4.9
Domestic currency borrowing abroad	70	42	105	93	-35	488	-7.7
Total	109	86	167	148	-18	855	-2.1
Plus: Direct lending to:							
Inside area non-banks	178	160	230	284	104	1,851	6.0
Outside area	11	13	-2	-12	8	756	1.1
Unallocated by country	12	1	15	45	-9	148	-5.7
Net international bank credit	300	260	410	465	85	3,610	2.4
Memorandum items:							
Interbank total	558	336	564	396	-205	4,742	-4.1
Redepositing	460	251	397	249	-187	3,887	-4.6

Source: BIS.

Table D also shows that direct lending to end-users within the BIS area grew much more slowly in 1991, largely because of economic and credit concerns: demand from non-banks was suppressed by the uncertain prospects for recovery and banks themselves were increasingly cautious about the creditworthiness of their borrowers. As a result, the growth of net international bank credit was markedly lower at \$85 billion.

Analysis by centre and currency

The United Kingdom remains the leading centre for cross-border bank lending, followed by Japan. Activity declined, however, in both centres during 1991. The US dollar share of cross-border lending continued to decline; but that of the Ecu grew again in contrast to the share of most of the individual European currencies (Table E).

Outside area business

Total claims on countries outside the BIS reporting area rose in 1991 and total liabilities fell (Table F). Thus net claims increased by \$21 billion, in contrast to sharp declines in

Table E
External lending

\$ billions; percentages in italics

	Stock	Exchange rate adjusted flows					Stock
	1986	1987	1988	1989	1990	1991	1991
By centre							
United Kingdom	21.8	90	33	55	86	-52	16.3
Japan	10.5	167	163	153	73	-36	15.1
United States	14.4	32	50	47	-28	7	9.4
France	6.2	38	23	55	65	-15	6.6
Switzerland	3.3	17	—	-6	46	-7	6.3
Germany	4.4	17	17	54	73	10	6.1
Luxembourg	4.3	19	19	37	42	18	5.0
Belgium	3.6	17	1	20	23	2	3.2
Netherlands	2.7	9	8	22	22	7	2.9
Italy	1.8	-2	3	19	2	5	1.5
Offshore	21.7	182	121	211	183	-1	23.3
Other	5.4	11	-3	19	23	6	4.2
Total	3,278	597	436	685	608	-56	6,240
<i>Of which:</i>							
Offshore	710	182	121	211	183	-1	1,456
Industrial area	2,568	415	315	474	425	-55	4,784
<i>Of which:</i>							
By currency							
US dollar	58.3	198	123	181	140	-78	45.2
Deutschmark	12.8	35	43	64	67	-17	14.2
Yen	8.7	128	71	113	43	-23	13.7
Swiss franc	6.6	2	-6	-4	19	-7	5.1
Sterling	3.2	14	30	24	34	-29	4.2
Ecu	2.1	8	16	21	21	16	3.6
French franc	2.1	9	5	16	38	20	3.6
Other	6.2	24	33	60	64	63	10.4

Source: BIS.

1989 and 1990 when claims fell slightly and liabilities rose sharply. As a result the BIS-area banks returned to a position of positive outstanding net claims (of \$30 billion) on outside-area countries, after a position of near balance last year. The oil exporting countries are the main group of net creditors of the banks.

Table F
External lending outside the BIS area

\$ billions

	Exchange rate adjusted flows					
	Liabilities			Claims		
	1989	1990	1991	1989	1990	1991
Developed	17	8	-3	3	6	1
Eastern Europe	—	-6	1	9	-10	-2
Oil exporters	14	26	-14	6	-2	-5
Non-oil developing:						
Latin America	4	19	-3	-17	-23	-1
Other	22	46	7	-3	17	14
Total	58	92	-13	-2	-12	8
	Stocks 1991					
	Liabilities		Claims		Net	
Developed	107		149		42	
Eastern Europe	22		92		70	
Oil exporters	234		134		-100	
Non-oil developing:						
Latin America	115		186		71	
Other	248		195		-53	
Total	726	756	756	756	30	

Source: BIS.

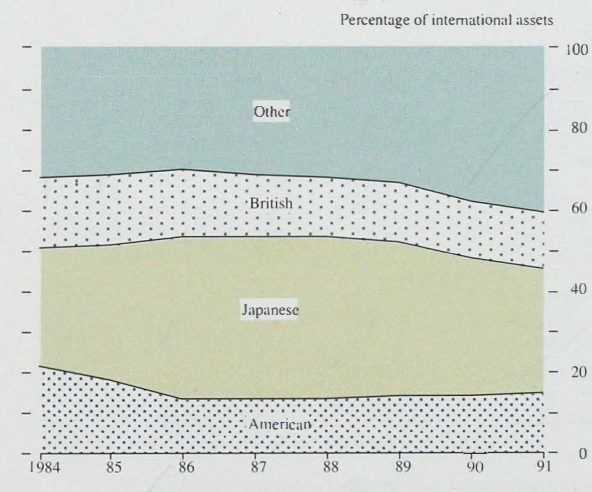
International banking business in London

London is the leading centre for cross-border lending, although, if local foreign currency lending is included, Japan is slightly ahead. Total international bank lending in London now exceeds \$1,300 billion, 18% of the BIS total. In line with the overall BIS trend, international banking business in London fell in 1991 after increases in previous years, with claims and liabilities falling by about 3%.

Although still by far the largest individual nationality group in London, *Japanese banks'* international lending fell by over 10% in 1991; their share of the total fell to 28.5%, down from 32.2% in 1990. This contraction was mainly owing to a decline in lending to their own offices and other banks overseas, with a continuing reversal on the liabilities side of their previous heavy reliance on CD issues.

In contrast, *American banks'* international business in London expanded during 1991, with an increase in lending to non-banks both overseas and within the United Kingdom. However, much of this increase arose from the reporting on balance sheet by some banks of the notional principal amounts associated with cross-currency interest rate swaps (such amounts will be excluded in future). Excluding this effect, American banks' share of total UK banks' international lending would fall significantly from the 15% in Chart 2 to only 10% and there would have been little or

Chart 2
International market share of major bank groups in London



no growth in their international balance sheets—illustrating the extent to which US banks have moved into off-balance-sheet activities in the United Kingdom.

Although *British banks'* international business in London fell slightly, their overall share rose marginally in 1991 to 15.6%, the first rise since 1985 when it stood at 20.6%.

The market share of the '*other overseas*' banks continued its growth since the mid-1980s, rising to 40.7% from 39.0% in 1990 (see Chart 2). The gains were made mainly in increased overseas investments and lending to non-banks, although these were partially offset by a fall in overseas interbank lending.

The small fall in UK banks' international business was more than accounted for by a decline in cross-border lending. Table G below shows the regional breakdown of such lending. The decline was largely within the BIS area, although claims on other countries continued to fall.

Table G
External lending of banks in the United Kingdom

\$ billions; percentage changes in italics

	Exchange rate adjusted flows					Stock	
	1987	1988	1989	1990	1991	1991	1991
BIS area	88	43	59	94	-46	858	-7.6
Outside reporting area:							
Developed countries	-1	-2	-2	1	-1	33	-4.8
Eastern Europe	1	2	2	-5	-3	14	-19.0
Oil exporters	-1	1	-1	-2	-2	16	-12.9
Non-oil developing countries	-3	-6	-4	-3	3	46	6.7
Other	4	-3	1	3	5	17	—
Total	88	36	56	88	-44	984	-4.1

Source: Bank of England.

International capital markets

International bonds

The volume of new international bond issues surged last year to a record \$329 billion (Table H). Buoyant primary markets were a feature of most currency sectors, and there were substantial increases in offerings of both straight fixed-rate and equity-related bonds. A number of factors lay behind this strength of borrowing activity; in particular, the

Table H
Announced international bond issues (a)

\$ billions

	1989	1990	1991
Fixed-rate bonds			
Straights	150.8	172.2	262.7
Equity-related bonds	85.1	33.1	43.7
of which:			
Warrants	69.5	22.6	31.7
Convertible	15.6	10.5	12.0
Bonds with non-equity warrants (currency, gold, debt)	0.5	0.1	1.0
Total fixed-rate bonds	236.4	205.4	307.4
Floating-rate notes	27.3	57.9	21.5
Total gross new issues	263.7	263.3	328.9
Repayments	89.2	108.0	146.7
Total net new issues	174.5	155.3	182.2

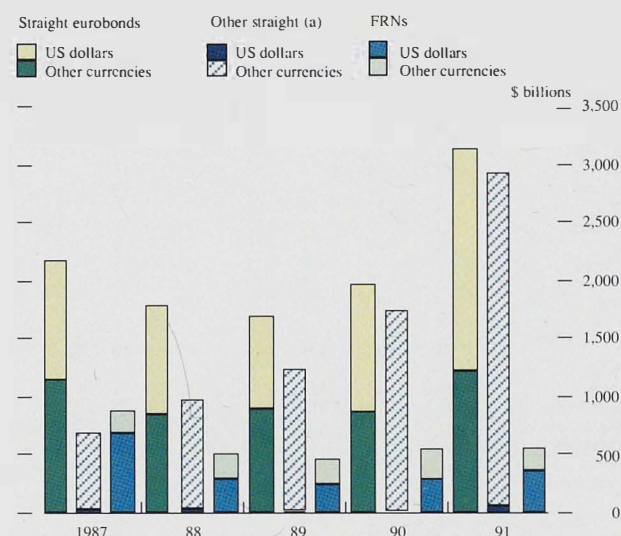
Source: Bank of England ICMS database. BIS.

(a) Difference in totals between Table A and Table H reflect the difference between announcements and completions.

large falls in long-term interest rates in all of the main markets and a deterioration in the terms available on bank credit. Gross issuance was also boosted by the rising level of capital repayments on international bond issues as issuers sought refinancing and investors reinvested funds: capital repayments on international bonds rose from \$109 billion in 1990 to nearly \$150 billion in 1991, and are estimated to rise to over \$230 billion in 1993. Japanese companies in particular face substantial redemptions of equity-related bonds.

In the secondary eurobond market, turnover rose strongly for the second successive year (Chart 3). This was partly related to the more active trading of bonds during the immediate post-issue period; but it was also associated with the rapid expansion of the Ecu sector of the eurobond market where liquidity benefited from a number of large benchmark issues by sovereign and supranational borrowers. Another important feature of the secondary bond markets in 1991 was the particularly sharp rise, by 67% to nearly

Chart 3
Secondary market turnover



Source: Euroclear and Cedel

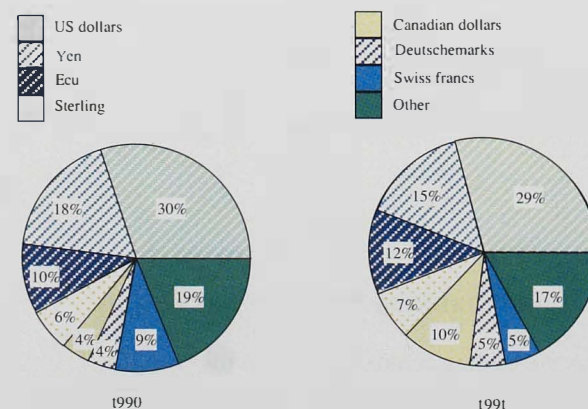
(a) Includes convertible fixed-income bonds in 1987 and 1988.

\$3,000 billion, in the volume of domestic fixed-rate securities settled on the Euroclear and CEDEL systems. Turnover of such securities through the two systems is now comparable in magnitude to eurobond turnover, a development which may be attributed to substantial international investor participation in several domestic European bond markets.

(i) Straight fixed-rate bonds

The total volume of straight fixed-rate issues in the international bond markets rose by 53%, to \$263 billion, in 1991. For the second year in succession much of the increase in issuance was associated with developments in the European currency sectors: issuance volumes almost doubled in the deutschmark, sterling, Ecu and French franc sectors (Chart 4).

Chart 4
Currency composition of announced straight fixed-rate international bonds



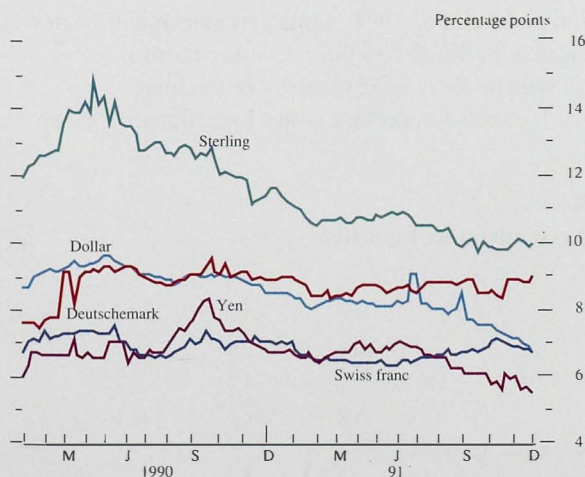
Source: Bank of England ICMS database.

Issuance in the dollar sector was buoyant, rising by 19%, although its share of total primary market activity contracted

slightly in 1991. Yields on dollar-denominated bonds fell during the course of the year as the US economy slowed and inflation prospects improved. By the fourth quarter, coupons on newly-issued dollar eurobonds had fallen to levels not seen for more than two decades. The strength of the exchange rate in the first half of the year also improved issuing conditions.

In the fixed-rate yen sector a very strong increase in borrowing by Japanese entities, from \$7.4 billion in 1990 to \$23.0 billion last year, boosted the volume of new issues. Japanese companies faced reduced options in meeting their funding requirements in the domestic market because of weak Japanese equity prices. However, they increased their recourse to the fixed-rate euroyen market to take advantage of reduced yields. They also increased issuance of equity-related bonds during the middle of the year, although the volume was well below the levels of 1988–89. The Japanese authorities have taken steps to increase the competitiveness of the primary domestic yen bond markets (for example by introducing more flexibility on maturities and lower fees). A separate development was the introduction of the fixed-price reoffer system—a technique which has gained wide acceptance in the international bond market—into the domestic yen bond market. In contrast to the sharp increase in issuance by Japanese borrowers in the euroyen market, yen-denominated offerings by non-Japanese entities in the international bond market were subdued.

Chart 5
International bond yields: 5-year bonds,
prime borrowers



Source: Salomon Brothers.

Most European currency sectors of the international bond market witnessed record issuance volumes in 1991, although the Swiss franc sector was a notable exception owing to investor concerns about inflation. Among these sectors, the Ecu consolidated its position as the largest provider of new funds. Nearly \$17 billion of new issues were offered in the Ecu sector in the first quarter of 1991, mainly by sovereign and supranational entities.⁽¹⁾ Borrowing activity in the Ecu

sector fell back in subsequent quarters, and was especially weak in the run-up to the Maastricht summit in the light of uncertainties about the future definition of the Ecu. The first few months of 1992, however, saw a sharp rebound in the volume of new issues. The French franc sector of the international bond market also experienced an exceptional year. Much of the increase in issuance was attributable to French borrowers offering bonds with a maturity of less than seven years, which they are not permitted to do in the domestic market; but the sector was also stimulated by growing international investor interest.

The Canadian dollar witnessed the most spectacular rise in new issuance activity in the international bond market in 1991. The increase in offerings in the sector, from \$5 billion in 1990 to \$18 billion last year, reflected increased institutional investor interest encouraged by a firm exchange rate against the US dollar, coupled with the higher yields available on Canadian dollar paper, and the very strong financing demands of Canadian entities. The global bond structure expanded into the Canadian dollar sector at the end of 1990 and has facilitated both an increase in the size of individual issues and a lengthening in bond maturities.

Other notable developments included the continued development of the market in asset-backed securities. Its growth has been assisted by an improved investor understanding of the risk of prepayment of the securities in the light of early repayment of the underlying assets (eg mortgages and credit card receivables). Nevertheless, primary activity in the asset-backed securities market slowed in the second half of the year; and the secondary market weakened because of increased concern about the quality of some of the underlying assets and downgradings of some banks and insurance companies providing credit enhancement for asset-backed securities.

Rapid growth of issuance activity in some of the smaller European currency sectors was in many cases associated with financial liberalisation. In the lira sector, the queuing system was abolished in the middle of the year and foreign institutions meeting certain criteria were permitted to lead-manage new issues. In the peseta sector, the range of eligible borrowers was widened to include state-owned agencies.

Several tax changes enacted during 1991 affected the relative attractiveness of domestic and international bonds denominated in the same currency. In Spain, withholding tax was abolished (on all bonds held by non-Spanish EC investors and on public sector bonds held by non-EC residents) at the start of the year, and in Italy in the early autumn the government began repaying withholding tax to eligible foreign investors. In Germany, a court ruling in the middle of the year prompted the authorities to reconsider allowing gross payment of coupons on domestic bonds, and towards the end of the year it was decided to introduce a new regime involving more generous tax allowances on interest income together with a system of 25% deduction of

(1) Recent developments in the Ecu financial markets are reviewed on pages 180–89 of this issue of the *Bulletin*.

interest income at source. Some switching in investor interest away from the domestic market appears to have resulted, and by the end of the year yields on deutschmark eurobonds (holders of which will continue to receive coupons gross) had fallen to levels comparable to those available on German government securities.

The predominant issuers of international bonds remain entities from OECD countries (Table J). Non-OECD borrowers accounted for 4% of new issuance in 1991, a higher proportion than for most of the 1980s. A particular feature recently has been the return of heavily indebted Latin American countries as issuers in the international bond market (see the box opposite).

Table J
Total eurobond borrowing activity by country grouping

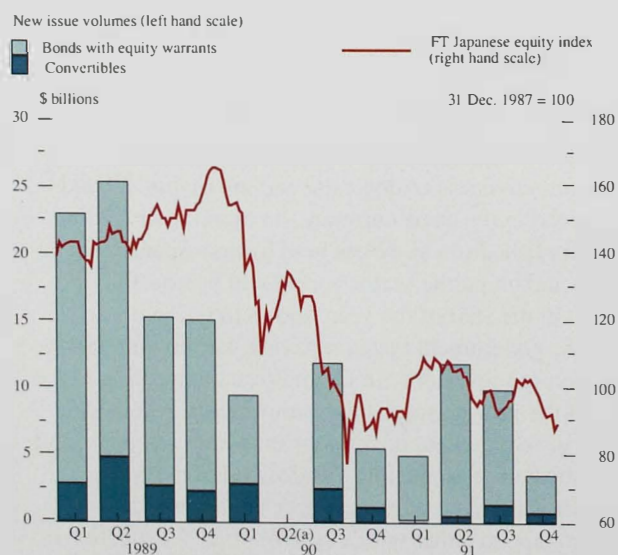
	1989	1990	1991
OECD	235.2	208.8	275.2
of which:			
United States	16.0	22.0	23.6
Japan	97.6	14.5	71.6
United Kingdom	25.6	23.6	36.0
Developing countries	2.8	6.0	12.8
Oil producers	0.4	0.8	0.8
USSR, China and Eastern Europe	2.0	16.8	1.6
International institutions	23.2	30.8	38.8
Total	263.6	263.2	329.2

Source: Bank of England ICMS database.

(ii) Equity-related bonds

At the beginning of 1991 share prices in Japan moved sharply higher, recovering some of the ground lost during the previous year. In response, Japanese borrowers in the international financial markets raised their equity-related issuance during 1991 as a whole by 15% on 1990, although volumes remained well below the levels of the late 1980s (Chart 6). Some currency diversification was evident in the pattern of new issues; for instance, a substantial number of Japanese entities offered bonds with equity warrants in the deutschmark sector.

Chart 6
Equity-related issues by Japanese borrowers



Source: FT actuaries world index and Bank of England ICMS database.

(a) Equity-related issues suspended.

Most of the increase in equity-related issues last year, however, was attributable to the activities of non-Japanese entities. Non-OECD borrowers, notably those from the newly-industrialising economies of East Asia, were active issuers of convertible bonds. Korean companies issued convertible bonds in order to satisfy international investor demand prior to the opening up of the domestic stock market at the beginning of 1992.

(iii) Floating-rate notes

The FRN sector of the international bond market was depressed throughout 1991 on account of credit quality and interest rate concerns. In the fourth quarter, issuance fell to a three-year low. The illiquidity of the FRN market has encouraged many entities seeking floating-rate liabilities to turn to the swap market. Asset-backed FRNs, which form a substantial share of new issues in the sector, became less attractive to investors because of weak property prices and increased concern about the quality of underlying assets. Despite this uncertain background, there were several noteworthy developments in the FRN sector, such as the first offering of yen-denominated Variable-Rate Notes (VRNs).

Euronotes

Developments in the Euronotes market were dominated by the very rapid growth of the medium-term note (EMTN) sector, although the volume of outstanding shorter-maturity instruments also expanded.

In the eurocommercial paper (ECP) market the stock of outstanding notes rose during the twelve months by 13% to \$79 billion at the end of 1991, while announcements of new programmes fell 18% to \$36 billion: this pattern is consistent with an increasing maturity of the market (Table K). The most important issues by nationality group

Table K
Announced euronote facilities

	1989	1990	1991
ECP/ECDs	49.1	44.2	36.3
NIFs/RUFs	10.3	2.8	1.6
MTNs (a)	12.2	23.5	54.2
Total	71.6	70.5	92.1

Source: Bank of England ICMS database.

(a) Includes ECP with MTN option and global MTNs.

continued to be Australian and UK entities, which together account for almost one third of ECP outstandings, but issuance of ECP by French residents rose sharply during the year. In Europe, several domestic CP markets have been opened up or liberalised (for example, in France and Finland) and their further development may be at the expense of the ECP market's growth in the future. A domestic deutschmark CP market opened at the beginning of 1991 and before the end of the year had attracted a number of German and non-German borrowers.

Recent developments in non-OECD borrowing in the international capital markets

After the onset of the debt crisis in 1982, very limited amounts of new funds were supplied to non-OECD borrowers through the international capital markets. Although the international bond market continued to provide funds to LDCs via international development agencies, capital issues by non-OECD borrowers virtually ceased. Towards the end of the decade this situation began to alter, and in the past two years the value of capital issues offered by non-OECD borrowers has almost trebled (see the table).

Borrowing by non-OECD entities in the international capital markets

\$ billions

	1988	1989	1990	1991
International bond issues (a)				
Straight fixed-rate	4.9	4.1	7.1	11.5
Equity-related	0.2	0.2	0.4	2.0
FRNs	0.8	0.9	1.0	1.6
Total	5.9	5.2	8.5	15.1
<i>of which, Latin America</i>	<i>1.2</i>	<i>0.6</i>	<i>3.6</i>	<i>7.8</i>
Credit facilities (announcements)				
Syndicated credits	10.5	27.2	41.9	48.5
Euro CP programmes	1.5	1.9	1.5	2.8
Other notes	1.2	0.7	1.0	0.5
Euro-MTN programmes	0.8	—	—	1.1
Total	14.0	29.8	44.4	52.9
<i>of which, Latin America</i>	<i>0.3</i>	<i>3.2</i>	<i>3.0</i>	<i>6.4</i>

Source: Bank of England ICMS database.

(a) Bonds issued as a result of debt rescheduling agreements are not included.

Only a limited number of different entities, however, have borrowed on the international capital markets. The most active issuers in 1991 were Latin American (Mexican, Brazilian, Argentinian and Venezuelan entities). These accounted last year for 60% of straight fixed-rate bonds offered in the international markets by non-OECD entities. Issues by these borrowers were often for quite short maturities (sometimes only two years, although Mexico has been able to issue at a range of maturities up to 10 years); but several proved to be extremely popular with investors on account of their high yields. The second most important group of borrowers, in terms of amounts raised, were East Asian—notably Korean entities, who raised \$2.6 billion in the international bond market. Among East European countries, only Hungary and Czechoslovakia made issues in the international bond market.

The return of a number of Latin American borrowers to the international capital markets has reflected growing confidence in their progress with market-oriented

adjustment policies and (for Mexico and Venezuela) the reaching of debt rescheduling agreements between governments and their creditor banks. (In the case of Mexico, a revival of economic growth was accompanied by the conclusion of a debt reduction package in January 1990. Argentine and Brazilian entities, however, returned to the international capital markets without such agreements being reached.) A wider range of capital markets has become receptive to Latin American borrowers (eg the first issue in the sterling sector on behalf of a Latin American borrower since the onset of the debt crisis was made by the United Mexican States in the fourth quarter of 1991). In addition, the terms of new issues have improved as investor interest has widened. Low dollar interest rates and a potential widening of their investor base have also encouraged some Latin American borrowers to tap international rather than domestic markets. It is believed that international issues have stimulated a repatriation of substantial amounts of flight capital.

Last year also saw increased interest from international investors in the equity and equity-related markets of some non-OECD countries. Some investment has taken place via country and regional funds, which invest directly in local stock markets; but foreign investment has also been encouraged through international equity offerings (eg privatisations in Mexico and Argentina). The volume of equity-related bonds offered in the international capital markets has been small; and most of these have been made by Korean borrowers.

Non-OECD entities have also established a number of Euronote programmes, although the volume of funds involved has so far been modest. Nevertheless, two large Euro-MTN programmes have been established on behalf of Mexican and Venezuelan borrowers since the beginning of 1991.

The return of some non-OECD borrowers to the international capital markets is a significant indication of the progress of their adjustment efforts. Nevertheless, finance raised in the international capital markets by countries emerging from debt difficulties remains comparatively modest in relation to their overall demand for external finance: and many indebted countries have not yet reached the stage of acceptability by a sufficient constituency of international investors to gain access as borrowers in the international capital markets.

The EMTN market's robust performance during the year—outstanding EMTNs rose from \$21.9 to \$38.5 billion over the twelve months—provided strong evidence of the market's growing maturity and wider acceptance of the instrument among international investors. Much of the growth occurred in non-dollar sectors, notably the lira, sterling and Ecu.

Although the EMTN market has made notable progress in the past two years, it continues to be less well developed than its domestic US counterpart: for example, US investors are more receptive to less creditworthy names, and longer-term maturities are more common in the US market than in the international market. Nevertheless, a further expansion of EMTN outstandings is likely, in view of the sharp increase in newly-announced programmes which took place in 1991.

Syndicated credits

The international syndicated credits market suffered a setback in 1991, with the total value of announcements falling to its lowest level since 1988. The value of loans arranged for entities based in the larger developed economies contracted sharply as demand for bank credit weakened at a time of world economic slowdown. A low level of mergers and acquisitions activity also depressed the demand for loans. The demand for syndicated credit finance in the aircraft and oil sectors expanded, however. The volume of syndicated credits arranged for non-OECD borrowers increased by 19%: this was mainly associated with large reconstruction loans for borrowers in the Gulf region in the second half of the year (Table L).

Table L
Announced eurocurrency syndicated credits

\$ billions

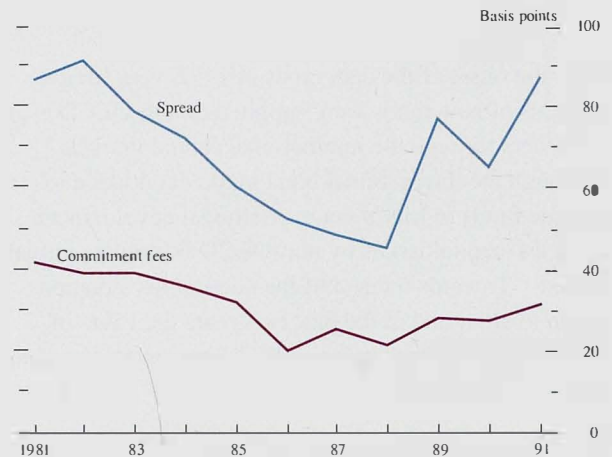
Country of borrower:	1989	1990	1991
Major OECD	103.9	94.0	56.2
Minor OECD	25.8	28.8	32.1
International institutions	0.1	0.3	0.6
Eastern Europe	2.2	12.1 (a)	3.6
Developing countries	25.0	29.8	46.4
Total	157.0	165.0	138.9

Source: Bank of England ICMS database.

(a) Of which \$5.3 billion is borrowing by the former East Germany.

The tightening of conditions in the international credit market is illustrated by the year-on-year increase in average spreads in 1991 (Chart 7): among OECD borrowers spreads rose from 0.55% to 0.65%, and among non-OECD borrowers they rose from 0.65% to 0.7%.

Chart 7
Commitment fees (a) and spreads (b) in the syndicated credits market



Source: Bank of England ICMS database.

(a) Average commitment fee for eurodollar loans to corporate borrowers.
(b) Average spread for eurodollar loans to corporate borrowers.

Concluding comments

The prospects for activity in international banking and capital markets depend crucially on the development of economic fundamentals (ie prospects for the world economy, inflation, interest rates and for budget and current account deficits among those countries which traditionally depend on international financing). Credit quality considerations remain an important influence on the pattern of market activity. Some major companies' concerns about the implications of high levels of borrowing for market sentiment have continued to depress their net demand for new finance, and banks' cautious assessments of risks are affecting the supply of credit—one consequence has been a continuation of the subdued levels of activity in the syndicated credit market in the first quarter of 1992. The first months of 1992 have also seen a continuation of last year's buoyancy of primary activity in the international bond markets, much of it related to refinancing operations. In spite of steps in recent years to modernise domestic capital markets, the international markets remain a competitive source of financing. A noteworthy development last year was increased access by non-OECD countries, in particular from Latin America, to the international markets. As well as being a sign of the recovery of creditworthiness by these countries, this trend could, if it continues, also have significant implications for the structure of international capital markets.