Financial market developments

Capital-raising in the international financial markets continued to be strong during the second quarter of 1992, although new issues fell back from the record amount registered in the first quarter. New issues in the international bond markets were stimulated by low and falling dollar interest rates. There was also renewed interest in floating-rate debt and new issues of floating-rate notes (FRNs) were higher than at any time since 1986, reflecting favourable swap rates and an upsurge in borrowing by banks.

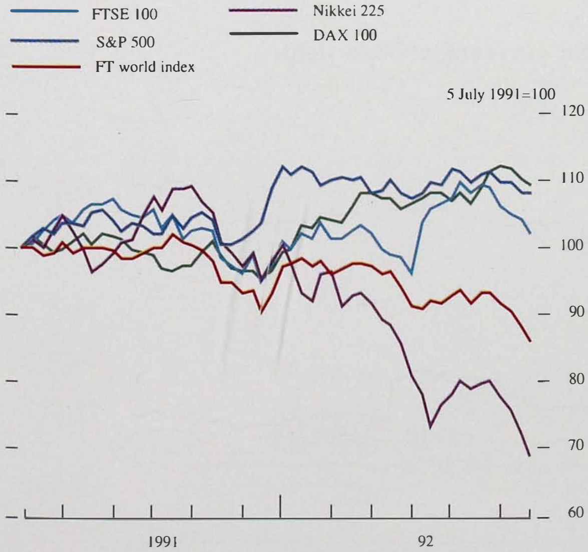
Capital markets remained buoyant

The domestic US capital markets again witnessed heavy new issues in the equity and fixed-income sectors during the second quarter. During the first half of 1992, corporate bond issuance was more than 40% higher by value than in the corresponding period in 1991. Spurred by recent reductions in long-term interest rates and reduced credit concerns, lower-rated entities made substantial borrowings and offerings of high-yield bonds reached a record level. New issues of fixed-rate international bonds in the first half of 1992 were 7% higher than the record figure in the corresponding period in 1991. Increased borrowing has partly reflected a sharp rise in offerings on behalf of European (notably French) and Canadian entities.

Continuing Japanese weakness dominated equity market developments . . .

Two episodes of particular weakness in Japan overshadowed other equity market developments in the second quarter of 1992. A sharp deterioration in sentiment at the beginning of the quarter reflected disappointment with the package of reflationary measures announced by the authorities and concerns about the financial sector, the shares of which fell sharply. The stockmarket experienced further weakness from mid-June, as expectations about corporate earnings and economic growth were revised downwards. Outside Japan, the US and the UK markets registered strong price gains in April, but these were subsequently lost in June, when prices retreated in all of the major markets (Chart 1).

Chart 1
International equity indices (a)



(a) End-week prices.

The effects of recent falls in Japanese equity prices continued to have wider repercussions. For example, in recent quarters Japanese banks have scaled back their international lending and increased margins on new loans in an effort to improve their capital ratios, which will have been eroded by stockmarket falls. The weakness of the stockmarket also means that equity-related finance is now in effect unavailable to most Japanese corporations.

. . . and added to pressures for structural change in the Japanese markets

Faced with the need to refinance substantial amounts of maturing equity-linked bonds, the Japanese corporate sector has been turning to other sources of funds, notably straight fixed-rate bonds. To assist such refinancing and to improve the competitiveness of the Japanese financial markets, the authorities are taking steps to widen and deepen the domestic Japanese corporate bond market (for example, by allowing companies to issue shorter-dated paper). The domestic market has long suffered in its competition with the international markets because of structural rigidities and relatively heavy regulation.

More generally, financial reform legislation was passed by the Diet in June, for implementation in 1993. This will allow banks and securities houses to enter each others' areas of business through subsidiaries and, *inter alia*, remove barriers between different types of banking. The reforms will have significant medium and long-term implications, although important details concerning the implementation of the new legislation have yet to be worked out.

Banks still faced loanbook problems, but there were some hopeful signs

Deteriorating asset quality continues to affect many banks in the major economies. There are signs, however, that in some cases the most severe phase of debt write-offs may be ending. In the United States, for example, banks' profits have recently improved, in part owing to lower bad debt charges. Some banks' debt ratings have been upgraded and banks' shares have recently performed well against the rest of the stock market.

Table A
Total financing activity:(a) international markets by sector

$ billions, by announcement date

	1991 Year	Q2	Q3	Q4	1992 Q1	Q2
International bond issues						
Straights	264.5	62.1	60.7	60.3	88.0	66.2
Equity-related	43.8	20.0	11.8	4.7	7.1	3.4
of which:						
Warrants	*31.8*	*13.1*	*9.6*	*3.6*	*5.3*	*2.4*
Convertibles	*12.0*	*6.9*	*2.2*	*1.1*	*1.8*	*1.1*
Floating-rate notes	21.5	6.5	4.4	4.2	6.1	12.7
Bonds with non-equity warrants (currency, gold, debt)	1.0	0.1	0.2	0.6	0.4	0.3
Total	**329.8**	**88.7**	**77.1**	**69.8**	**101.6**	**82.6**
Credit facilities (announcements)						
Euronote facilities	92.1	27.3	16.3	26.5	19.6	23.6
of which:						
CP	*36.3*	*9.5*	*10.5*	*10.2*	*4.0*	*2.3*
EMTNs	*54.2*	*17.6*	*5.6*	*16.2*	*15.5*	*20.7*
NIFs/RUFs	*1.6*	*0.2*	*0.2*	*0.1*	*0.1*	*0.6*
Syndicated credits	136.4	31.5	28.1	37.4	27.3	79.6
Total	**228.5**	**58.8**	**44.4**	**63.9**	**46.9**	**103.2**
Memo: amounts outstanding						
All international						
Bonds(b)	1,650.2	1,451.9	1,547.3	1,650.2	1,607.1	. .
Euronotes(c)	144.9	129.5	136.9	144.9	156.2	166.5
of which, EMTNs	*38.5*	*26.6*	*31.4*	*38.5*	*41.0*	*47.5*

. . not available.

(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.
(b) BIS adjusted figures, including currency adjustment. Includes issues of fixed-rate bonds and floating-rate notes.
(c) Euroclear figures.

European banks tapped the US capital markets

In recent months, several European banks have turned to the US financial markets in order to strengthen their capital ratios by making subordinated debt issues. Long-term subordinated debt counts as Tier 2 capital and European banks have found it hard, or prohibitively expensive, to raise such capital in their own markets. US investors, however, are more willing to acquire debt instruments of this kind than are their European counterparts. Moreover, banks issuing these bonds have been able to raise longer-term funding than would be feasible in either the euro or domestic European markets.

New debt issues and turnover in international capital markets

Overall, fixed-rate bond activity was lower . . .

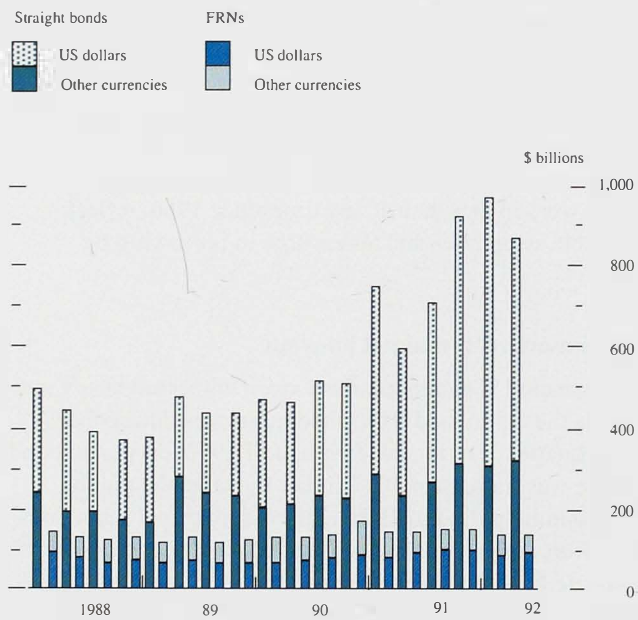
International dollar fixed-rate bond issues were firm in the second quarter, partly reflecting reduced credit concerns and a consequent narrowing of spreads over US Treasuries (Tables A and B). Borrowing fell sharply in several other sectors, however, notably those of the Ecu, Italian lira and Japanese yen (Table B). Overall, turnover of fixed-rate bonds was high, although below the record levels of the previous two quarters (Chart 2).

Table B
Currency composition of straight fixed-bond issues

Percentage of total issues announced

	1990 Year	1991 Year	Q4	1992 Q1	Q2
US dollar	30	28	29	28	35
ECU	10	12	3	18	8
Deutschmark	4	6	9	9	9
Swiss franc	9	5	4	3	2
Sterling	6	9	6	6	10
Canadian dollar	4	9	6	5	9
Yen	18	15	21	13	8
French franc	4	6	10	5	11
Australian dollar	4	2	2	2	1
Other	11	8	10	11	7

Chart 2
Straight bonds and FRNs: secondary market turnover

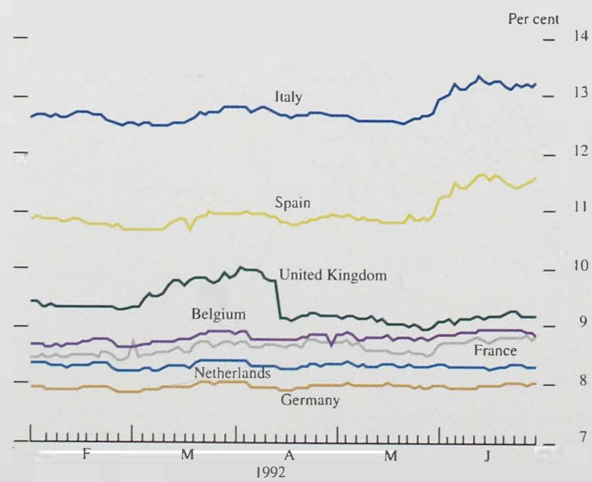


Source: AIBD.

. . . partly reflecting the effects of the Danish referendum result on European currency bonds . . .

Some European currency sectors of the bond markets were strongly affected by the Danish voters' narrow rejection of the Maastricht Treaty at the beginning of June (Chart 3), which has continued to overhang European bond markets. The referendum result dented investors' previous confidence that bond yields in Europe would continue to converge and bond prices fell back in most markets, especially those where the Maastricht criteria would provide external discipline on domestic policy. The sterling bond market was relatively little affected.

Chart 3
Ten-year government bond yields



International banking developments

The international activity of banks in the BIS reporting area fell in the first quarter of 1992 after picking up in the previous quarter, resuming the decline seen through most of 1991. Their outstanding cross-border assets fell by $40.5 billion and cross-border liabilities by $31 billion. The decline in cross-border assets was more than accounted for by a sharp contraction in cross-border interbank claims (which fell by $81.2 billion). This mainly resulted from a drop in levels of interbank business with Japan, reflecting the efforts of Japanese banks to meet international minimum capital standards. The decline, which repeats the fall seen in the first quarter of 1991, contrasts markedly with the typical end-March expansion of balance sheets during the 1980s.

Estimated new international bank lending (net of redepositing in the interbank market) rose modestly to $30 billion in the first quarter of 1992, in line with the average growth in 1991, but well below that of previous years.

Countries outside the reporting area increased their borrowing from BIS-area banks by $9.6 billion in the first quarter, while their outstanding deposits fell by $8.8 billion, owing largely to falls in deposits from Asian and OPEC countries (which fell by $8 billion and $7 billion respectively). Banks' outstanding claims on OPEC countries rose by $5.2 billion. Outstanding claims on Latin America increased by $3.5 billion, with claims on Mexico and Brazil up by $3 billion and $1 billion respectively. Sizable new credits were granted to South Korea ($1.8 billion), which also increased its outstanding deposits by $1.1 billion. Banks' exposure to China, which introduced restrictions on external borrowing at the start of 1992, fell by $1.2 billion. Banks' liabilities and assets *vis-à-vis* Eastern Europe both rose by $0.9 billion, within which new officially guaranteed credits allowed claims on the former Soviet Union to grow by $1.7 billion.

The London market

In the first quarter of 1992, the cross-border business of banks in the United Kingdom continued the falls seen during 1991 on both sides of the balance sheet. Liabilities and claims fell by $14.6 billion and $6 billion respectively. The decline was more than accounted for by lower interbank activity, mainly with banks within the BIS area, where liabilities were down by $18.6 billion and claims by $17.1 billion. Claims on banks in Japan fell for the sixth consecutive quarter, with a sharp drop of $18.9 billion. The fall in interbank liabilities was well spread, relating mainly to banks in Germany ($5.4 billion), Italy ($4.9 billion), France ($3.7 billion) and Japan ($2.5 billion). By contrast, claims on non-banks within the BIS area rose by $8.6 billion.

Business with countries outside the BIS area was fairly flat. The largest movement was a fall in liabilities to oil exporters of $2.9 billion, reflecting a further fall in deposits from Saudi Arabia and Kuwait. Claims on Eastern Europe continued the decline begun in the fourth quarter of 1989.

Japanese banks in London continued to retrench, with their share of cross-border business falling sharply from 31.3% to 28.8%. British banks' market share rose from 15.1% to 15.6%, and the share of 'other overseas banks' rose from 42.2% to 44.2%. Within this, EC banks now account for 27.6% of total cross-border business. The share of German banks has increased significantly in recent years, reaching 11.2% in the first quarter of 1992, close to that of US banks (11.4%). The US dollar's share of UK cross-border lending increased from 48.1% to 49.0%, gaining at the expense of both the deutschmark, which fell from 15.2% to 14.6%, and the yen, which fell from 10.7% to 10.2%.

Provisional data for the second quarter of 1992 show that the international business of banks in the United Kingdom fell on both sides of the balance sheet, with liabilities and claims down by $11.1 billion and $4 billion respectively. The falls were more than accounted for by Japanese banks, whose liabilities fell by $16 billion, mainly owing to a $9.8 billion reduction in CDs issued to overseas residents, and whose assets fell by $15.5 billion, reflecting a reduction in their business with their own offices abroad. American banks also reduced their activity on both sides of the balance sheet, with liabilities and claims down by $4.1 billion and $3.1 billion respectively. By contrast, the liabilities and claims of 'other overseas' banks grew significantly, by $10.7 billion and $12.2 billion respectively. The rise in liabilities reflected an increase in CDs issued to overseas residents ($8.6 billion); the rise in assets mainly resulted from increased business with own offices abroad ($7.4 billion) and overseas interbank business ($5.3 billion). British banks reported a modest fall in liabilities ($1.7 billion) and a small rise in claims ($2.4 billion).

Cross-border business of banks in the United Kingdom

$ billions: changes exclude estimated exchange rate effects

	1991					1992	Out-standing at end-March 1992
	Year	Q1	Q2	Q3	Q4	Q1	
Liabilities to countries:							
BIS industrial area	-41.3	-9.7	-32.7	6.8	-5.7	-22.3	671.6
of which:							
United States	*-21.2*	*-9.3*	*-10.4*	*8.0*	*-2.0*	*-10.8*	*126.4*
Japan	*-13.3*	*-2.3*	*-1.6*	*0.3*	*-8.4*	*-2.5*	*91.9*
'Offshore' centres	-9.3	-2.4	-2.6	-1.3	-3.0	3.1	113.1
BIS reporting area	**-50.6**	**-12.1**	**-35.3**	**5.5**	**-8.7**	**-19.2**	**784.7**
Other developed	-0.1	-2.9	1.5	0.8	0.4	2.0	35.3
Eastern Europe	-0.6	-1.9	0.1	1.2	-0.1	0.3	5.6
Oil exporters	-1.5	-0.2	2.9	-1.3	-2.8	-2.9	63.5
Non-oil developing	1.7	-1.1	2.1	1.4	-0.7	-1.3	57.5
of which, Latin America	*0.0*	*-0.2*	*0.9*	*0.1*	*-0.8*	*-0.1*	*7.8*
Outside BIS area	**-0.5**	**-6.1**	**6.6**	**2.1**	**-3.2**	**-1.9**	**161.9**
Other (a)	12.1	15.7	-3.5	-7.8	7.8	6.5	115.0
Total	**-39.0**	**-2.5**	**-32.2**	**-0.2**	**-4.1**	**-14.6**	**1061.6**
Claims (b) on countries:							
BIS industrial area	-29.9	0.6	-24.5	-3.2	-2.8	-8.5	704.5
of which:							
United States	*-10.9*	*-12.0*	*-4.0*	*5.2*	*6.5*	*0.8*	*139.1*
Japan	*-40.6*	*-10.2*	*-10.8*	*-6.4*	*-12.1*	*-18.0*	*162.4*
'Offshore' centres	-16.3	-4.0	-5.7	-0.7	-6.4	-2.8	108.0
BIS reporting area	**-46.2**	**-3.4**	**-30.2**	**-3.9**	**-8.8**	**-11.3**	**812.5**
Other developed	-1.4	-0.9	-0.2	0.5	-0.8	1.1	33.0
Eastern Europe	-3.2	-1.2	-0.7	-0.6	-0.6	-0.6	12.5
Oil exporters	-2.4	-2.5	0.4	-1.0	0.8	0.5	16.0
Non-oil developing	3.0	2.0	0.3	0.5	0.1	1.4	46.8
of which, Latin America	*2.1*	*1.1*	*1.0*	*-0.5*	*0.5*	*1.3*	*26.4*
Outside BIS area	**-4.0**	**-2.6**	**-0.2**	**-0.6**	**-0.5**	**2.4**	**108.3**
Other (a)	**6.4**	**0.2**	**1.1**	**4.6**	**0.4**	**2.9**	**21.8**
Total	**-43.8**	**-5.8**	**-29.3**	**0.1**	**-8.9**	**-6.0**	**942.6**

(a) International organisations and unallocated; also, for liabilities, international issues of securities.
(b) Including securitised lending.

... and on Ecu bonds

The Danish referendum precipitated a sharp change in sentiment in the Ecu bond sector; yields rose sharply in two rounds of selling pressure and issuance—with the exception of regular auctions of UK debt—came to an almost complete halt. In the immediate aftermath of the Danish referendum, Ecu bonds underperformed German and French government bonds, but they seemed by mid-June to have found a new trading level, although the extent to which their yields were below the theoretical yield (a weighted average of bonds denominated in component currencies) was much lower than earlier in 1992. The regular tender of UK Ecu Treasury bills on 9 June was, however, well supported, at yields well below LIBID.

The Ecu market began to lose ground again in mid-July, reflecting concerns that other countries might not ratify the Maastricht treaty. Selling was particularly evident at fifteen to twenty-year maturities, a relatively new sector where investor demand is perhaps less well established; the ten-year sector was less affected, although yields moved above theoretical levels for the first time since 1990. The regular tender for ECU 500 million of UK three-year Treasury notes was held on 21 July and was two and a half times covered, at a yield about 25 basis points below the theoretical level. Notes outperformed long and intermediate Ecu bonds as the slide gathered pace, reflecting substitution out of long-dated debt.

After the Danish result, many investors switched out of Europe, to the benefit of bond markets elsewhere. The Canadian dollar sector was an important recipient of these funds and favourable conditions allowed two large global bond offerings to be made in June. Boosted by these issues, total borrowing in the sector rose sharply from its first quarter level.

French franc issues reached record levels

Prior to the Danish referendum, the French franc sector witnessed a flurry of new issues, which resulted in record borrowing in francs over the quarter. Investors were attracted by low French inflation and high real interest rates. Most of the issues were for French borrowers, as there were limited swap opportunities in the market. Many French entities have tapped the eurobond market in the last year because it still has a number of advantages over the domestic French franc bond market, despite efforts to widen the appeal of the domestic market, for example, by extending the range of eligible maturities. Highly-rated names can borrow more cheaply in the eurobond market, which can also handle larger issues. French franc domestic issues are held back by a rigid registration system and fixed quota syndication.

Equity-related bonds were subdued

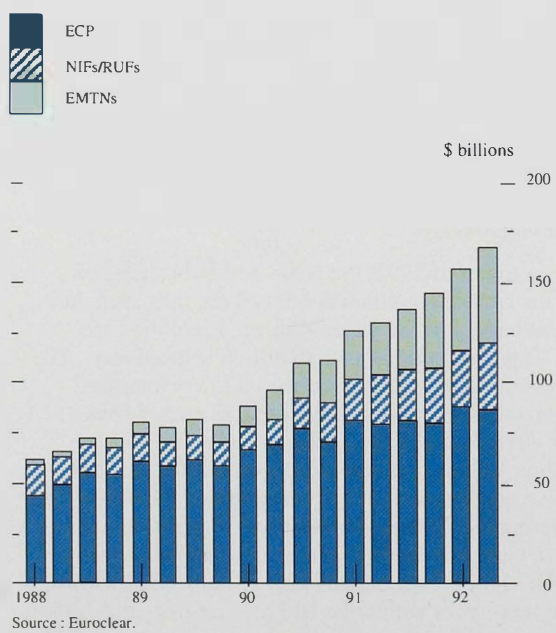
Only a handful of Japanese companies raised funds in the equity-related sector of the bond market during the second quarter and, although one large transaction was arranged for a German entity, the total of new issues was very subdued. Activity in the international equities market was relatively buoyant, particularly early on in the quarter. Several large issues were made, including a substantial tranche on behalf of a US entity and some further Latin American privatisations. Equity market sentiment deteriorated towards the end of the quarter, however, and two large international equity offerings, on behalf of an aircraft leasing company and a Mexican bank, were cancelled in June.

In India, changes announced in the February budget, which simplified issuing procedures and cut withholding tax and capital gains tax, facilitated international equity offerings on behalf of Indian entities. Several such issues were made in April and early May, before the news of a financial scandal on the Bombay Stock Exchange.

The EMTN market continued its strong growth

Euro-medium-term notes (EMTNs) comprised the great majority of newly-announced euronote programmes in the second quarter. The EMTN market continues to mature and is experiencing a period of very rapid growth. Figures published by Euroclear show that the stock of EMTNs rose by 16% in the second quarter and by 79% in the twelve months to the end of June (Chart 4). The expansion of the euro-commercial paper (ECP) market, which is about twice the size of the EMTN market at present, has recently been much more modest and the stock of outstanding ECP actually contracted slightly in the second quarter.

Chart 4
Stock of outstanding euronotes



Source : Euroclear.

In mid-May, an underwritten EMTN issue of ECU 250 million ($0.3 billion) by the Kingdom of Spain prompted speculation that such offerings would make inroads into traditional eurobond business. EMTN issues have several advantages over ordinary eurobonds: documentation costs are lower than for eurobond offerings, they can be executed extremely quickly and they are more flexible. Following the Spanish transaction, several other underwritten bond issues were made via EMTN programmes.

Borrowing by Latin American entities remained strong in the second quarter. Uruguay became the fifth sovereign borrower from the region to return to the international bond markets, making a $100 million three-year offering. In early May, the Brazilian central bank announced new tax regulations and maturity restrictions intended to curtail shorter-term borrowing by Brazilian entities in the international capital markets, although Brazilian borrowers continued to be active during the remainder of the quarter.

Syndicated credit activity picked up

The syndicated credit market is still affected by uncertainties over the credit standing of potential borrowers and by banks' caution as they seek to enhance asset quality and profitability. Nevertheless, the total value of syndicated credits arranged in the second quarter was sharply up on its first quarter level, largely on account of very substantial borrowing by US entities. Several large syndications were arranged for US corporations, some of which were refinancing earlier loans negotiated in the international financial markets.

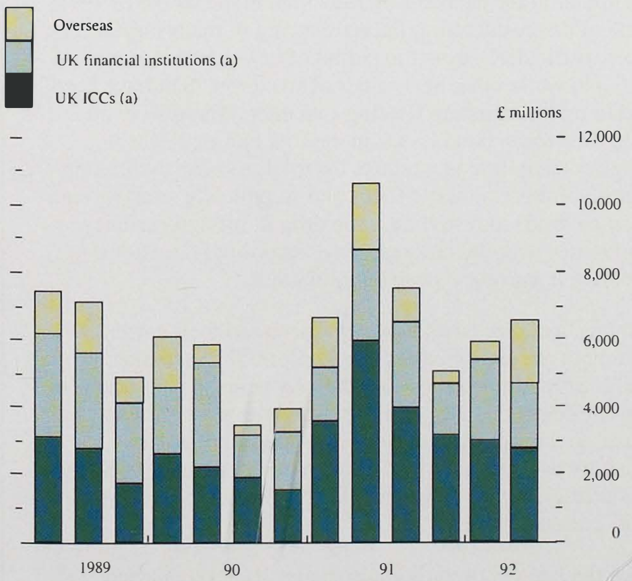
Domestic markets

New issues and turnover

Sterling new debt issues were strong; equity issues were more subdued

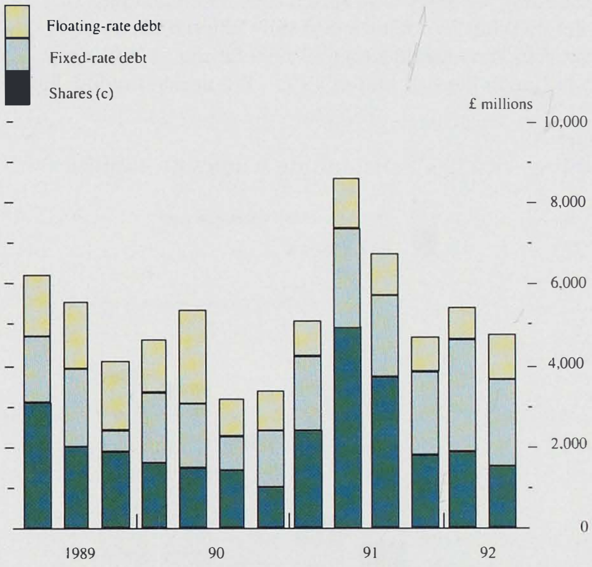
Following the election, sterling bond and equity prices rose very sharply. New issues of sterling debt and equity announced during the second quarter consequently rose to £6.6 billion. Nearly one third of the total was accounted for by overseas issuers (Chart 5). Fixed-rate debt issues announced during the quarter totalled £3.5 billion, with £2.2 billion issued in April, mainly just after the election. The quarter saw the largest ever straight sterling corporate offering (£500 million). Announcements of FRN issues doubled to £1.6 billion (Chart 6), reflecting strong issuance by building societies (see the box on page 284) and overseas borrowers against a background of lower UK interest rates and narrow swap spreads. The value of new equity issues fell, however, with the value of new shares offered by investment trusts considerably lower than before the Budget and at the end of the financial year.

Chart 5
Sterling capital issues announced: by type of issuer



(a) Includes issues by overseas subsidiaries of companies.

Chart 6
Sterling capital issues announced (a) by UK borrowers: (b) by instrument



(a) Further details can be found in the Bank's monthly Capital Issues Press Notice.
(b) Including issues by overseas subsidiaries of UK companies.
(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.

At the end of June, the credit ratings of five sterling mortgage-backed issues were reduced. This reflected a deterioration in the quality of the underlying mortgages and the depressed state of the UK housing market; previous downgradings of mortgage-backed issues had stemmed from reductions in the credit ratings of insurance companies guaranteeing the issues.

Twenty MTN programmes with a sterling option were notified to the Bank during the second quarter. The amount outstanding under sterling MTN programmes at the end of the second quarter totalled £1.6 billion, compared with £1.3 billion at the end of March. Sterling commercial paper outstanding at the end of the second quarter rose to £4.8 billion, in line with the same period last year.

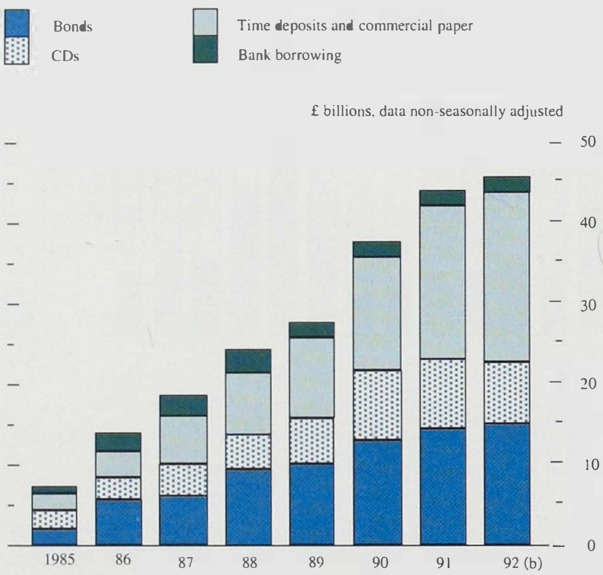
Turnover increased around the election

Average daily turnover in domestic equities during the second quarter was £1.8 billion, 20% higher than in the previous quarter, as activity picked up around the election (Chart 7). The increase in turnover was reflected in narrower spreads. The average touch (the difference between best bid and offer prices, as a proportion of the mid-price) on the FTSE 100 stocks narrowed from 1.2% to 1.1%. The average touch on second and third-line stocks narrowed to 6.5% and 9.9% respectively. Average daily turnover in non-UK equities rose by 17% to £1.4 billion in the second quarter. Within this total, trading in US stocks,

Building societies: some developments in wholesale funding

UK building societies have raised substantial amounts of wholesale funds in domestic and international markets (Chart A). They raised a total of £6.9 billion in 1991 and £4.5 billion in the first half of 1992. Wholesale funding has

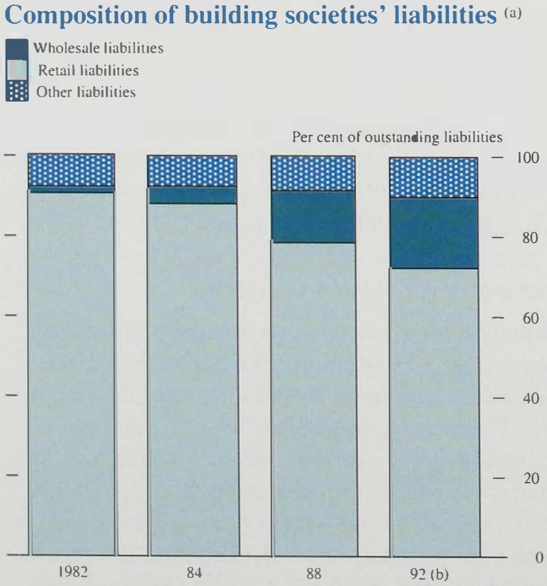
Chart A
Building societies' outstanding wholesale liabilities (a)



(a) End-period.
(b) To end-June.

accounted for a growing share of societies' total funding (Chart B), which has increased fourfold since the end of 1982. Two legislative changes have encouraged this trend. First, tax changes from 1983 onwards, allowing societies to pay gross (rather than net of tax) interest on certain instruments, have made capital markets more accessible. Second, the Building Societies' Act of 1986 has also allowed a gradual widening of the societies' asset and liability base. Under current legislation, there is an upper limit of 40% on wholesale funding. The rise in wholesale funding has enabled societies to economise on liquid assets, as wholesale funds provide an alternative source of marginal liquidity.

Chart B
Composition of building societies' liabilities (a)



(a) Using non-seasonally adjusted data.
(b) To end-June.

During the last year, building societies have further diversified their wholesale liabilities, with several issuing a new sterling instrument—permanent interest-bearing shares—as well as establishing more euro-medium-term notes and euro-commercial paper programmes.

The first issue of permanent interest-bearing shares (PIBS) was made in June 1991, after a ruling by the Building Societies Commission (BSC) allowing such issues (in the light of provisions in the 1991 Finance Act). The main characteristics of PIBS are:

- they are perpetual instruments (but may, with the permission of the BSC, carry a five-year call option);
- in the event of winding up, PIBS are subordinate to the claims of all other shareholders and liability holders;
- PIBS can pay fixed or floating interest, but interest must not be linked to surpluses; and
- interest can be waived or reduced if it would cause the issuer to breach capital adequacy requirements. If interest payments are waived, there is no obligation to pay arrears of interest in future years.

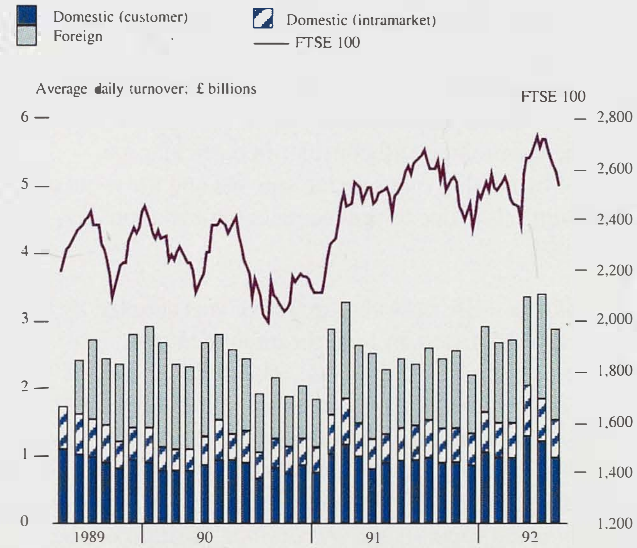
PIBS qualify as Tier 1 capital under the EC Own Funds Directive and so offer building societies an opportunity to increase their core capital, as an alternative to increases in reserves. By the end of June 1992, five building societies had issued PIBS and four others had issued bonds convertible into PIBS on condition of shareholder agreement. The sums raised by PIBS have so far been quite small, mostly ranging from £20–£60 million. The first issues were by larger societies, but, as investor familiarity has grown, smaller societies have also begun to launch issues.

The gross value of sterling bond issues by building societies was higher in the first half of 1992 than in the whole of 1991. Some of this results from the refinancing of maturing earlier issues, particularly from the period of heavy issuance in 1986–88, while other new issues of fixed-rate debt have been used to replace existing floating-rate debt. There were no foreign currency bond issues in the first half of 1992. Societies have little natural use for foreign currency funding because of their domestic focus and so typically swap foreign currency funds into sterling. The drop in foreign currency bond issues over the last year may, accordingly, reflect a reduction in currency swap opportunities.

Building societies have, however, increased their currency funding in the euro-medium-term note (EMTN) market. EMTN programmes allow building societies to tap pockets of investor demand in one or more currencies at very short notice, so taking advantage of swap opportunities too transitory to exploit through large public bond issues. So far, six societies have established EMTN programmes; most allow multi-currency issues.

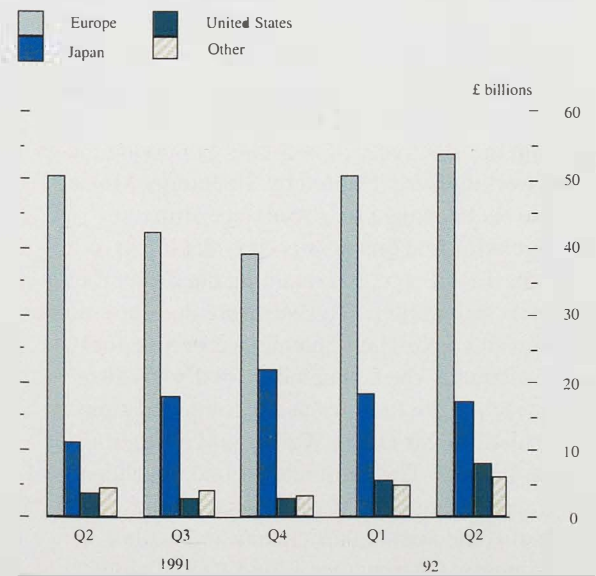
Since the late 1980s, building societies have established fifteen euro-commercial paper programmes and fourteen sterling programmes. Euro-commercial paper has tended to be a far larger source of funds for the societies than the sterling CP market—sterling CP outstanding at the end of June 1992 amounted to only £0.5 billion, while foreign currency CP outstanding totalled £4.3 billion.

Chart 7
Equity turnover and prices on the London Stock Exchange



which nearly doubled during the first quarter, increased by almost a half (Chart 8). US stocks still account for only 9% of total trading of international equities in London and London's share of trading in US stocks averages under 1%.

Chart 8
Composition of overseas equity turnover in London: value of turnover



The FTSE 100 index rose from around 2,400 at the end of March to an all-time high of 2,738 on 11 May, including a rise of 8% during the week after the election. Towards the end of the quarter, however, as signs pointed to the weakness of the recovery in the UK economy and concerns grew about German interest rates, the index fell back and ended the quarter at 2,521. The Eurotrack 100 index of leading non-UK European stocks averaged 1,170 over the quarter, reaching a high of 1,200 on 2 June but ending the quarter on a low of 1,139.

Turnover in the gilt-edged market averaged £4.3 billion per day in the second quarter, compared with £5.1 billion in the first quarter. The average number of bargains rose to some 2,900 per day from 2,600 in the first quarter.

Stock Exchange member firms moved back into profit

The aggregate profits of London Stock Exchange member firms in 1991, excluding gilt-edged market-makers, were £286 million—a major turnaround from the losses of £353 million made in 1990. Revenue was £3.2 billion in 1991, 35% higher than in 1990 but still a little below 1989 levels and total commission income rose by 19%, despite lower average commission levels; corporate fee income rose by 22%. Expenditure rose by 7% from 1990 to £2.9 billion, but salaries (the largest element of costs) increased by only 1%.

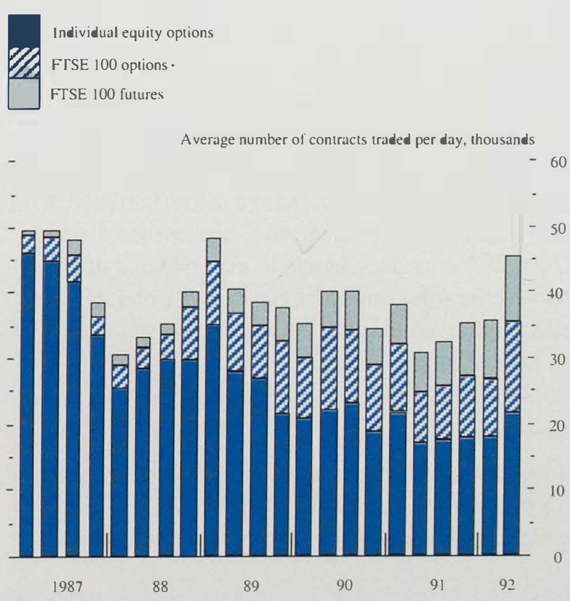
The Stock Exchange launched a pilot scheme in April for an order-driven system for trading in less liquid stocks, which is designed to concentrate on cost-effective trading rather than on provision of liquidity by market-makers, the system more generally used in the UK equity markets. The scheme, known as the Company Bulletin Board, covers over eighty third-line stocks. Buy and sell orders, completed trade details and company and historical market information are displayed. Initial indications are that intramarket activity has increased significantly, but remains concentrated in a few stocks.

Futures and options

Market uncertainties boosted trading

Turnover on London's futures and options exchanges rose by a further 4% in the second quarter of 1992 and was over 50% higher than a year earlier. Much of the rise was prompted by the reaction of the financial markets to the result of the general election and the Danish referendum. In the first full quarter since its merger with LTOM, volume on LIFFE rose by 3% and was 68% higher than aggregate LIFFE/LTOM volume a year earlier. As Chart 9 shows, turnover in equity contracts has increased since the merger; much of the growth was generated by high volatility in the

Chart 9
Turnover of equity futures and options on LIFFE/LTOM



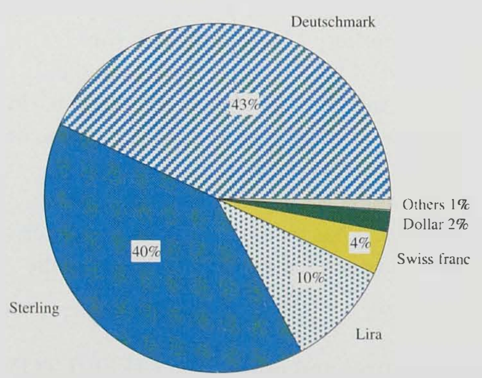
Source: LCH./LOCH.

underlying cash market. Trading of base metal and energy futures and options also remained buoyant.

The much delayed launch of the GLOBEX worldwide electronic trading system took place in June. The project has been jointly developed by Reuters, the Chicago Mercantile Exchange (CME) and latterly the Chicago Board of Trade (CBOT). In addition, the MATIF has become a partner exchange and four of the five New York commodity exchanges have expressed an interest in joining. Contract listings will be phased in and began with the CME's currency futures and options. Although the relative importance of US dollar-denominated contracts to LIFFE has diminished with the success of LIFFE's European contracts, LIFFE introduced incentive schemes on its US contracts ahead of the GLOBEX launch.

Trading in LIFFE's Italian government bond (BTP) future reached over 640,000 contracts during June, more than double the previous monthly record. LIFFE's eurolira future, launched in May, made a promising start with an average of some 2,200 lots transacted each day. The growth of lira-denominated contracts has made them in under a year the third most actively traded on LIFFE (Chart 10).

Chart 10
Composition of LIFFE futures by currency: Q2 1992



Source: LCH.

Activity on London's largest commodity futures and options exchange, the London Metal Exchange, continued to grow, with a 10% increase in the second quarter. Rising oil prices at the International Petroleum Exchange also stimulated a 10% rise in volume, with turnover 46% higher than a year earlier. The only London exchange to experience a decline in business was the soft commodities market, London FOX, largely reflecting the continuing decline in raw sugar volumes at the exchange.

Regulation

Responsibility for financial services regulation has moved from the Department of Trade and Industry (DTI) to the Treasury. Responsibility for the regulation of insurance companies and most Companies Act powers will remain at the DTI.

The Government has established a Pensions Law Review Committee under Professor Goode to review the legal and regulatory framework for occupational pension schemes, following the misappropriation of Maxwell pension fund assets. The Committee will consider in particular the question of ownership of a scheme's assets and the issue of accountability. It is due to produce recommendations by summer 1993.

The EC third non-life insurance directive was adopted by the EC Council of Ministers in June for implementation into national legislation by 1 July 1994. The directive gives UK and other EC insurers a 'passport' to sell a full range of non-life insurance products throughout the European Community, either by local establishment or through cross-border provision of services, on the basis of home state authorisation and supervision. A common position on the EC third life insurance directive, which largely mirrors the provisions of the non-life directive, was also reached in June.

Structural changes are to be made to the Lloyd's insurance market, following the publication of three reports. Lloyd's has already made considerable progress in implementing the recommendations in the Task Force report published in January and is now examining the measures necessary to introduce corporate capital. A stop-loss scheme along the lines suggested in the report, capping Names' cumulative losses over four years at 80% of premium income limits, is to operate from the 1993 year of account. Following the report of the working party chaired by Sir Jeremy Morse, Lloyd's is also set to change its governance structure, separating regulation and business policy-making as proposed by the Task Force, but retaining the Council of Lloyd's as an overall arbiter. This structure does not require new legislation and so can be implemented in time for the 1993 year of account. The Council of Lloyd's has also accepted in principle the findings and recommendations of a committee chaired by Sir David Walker into allegations of malpractice at Lloyds. The committee found no evidence of systematic fraud or abuse, but it was critical of the performance of some market participants and made a number of proposals to strengthen Lloyd's regulation.

Settlement

The Bank has decided to develop an electronic book entry transfer system with assured payments for Ecu securities, to be called ESO (European Settlements Office).(1) ESO is intended to meet market participants' needs for improved settlements of Ecu securities, including same-day setlement and is expected to become operational around the middle of 1993. The establishment of ESO will complement the Bank's liquidity facilities for menbers of the Ecu cash clearing mechanism; these were announced last year and will shortly be in place.

(1) See: 'Ecu securities markets', May 1992 *Bulletin*, page 186, where the Bank was said to be 'actively considering' such a system.

Issues of dematerialised certificates of deposit (CDs) held in the Central Money Markets Office have been facilitated by the latest Finance Act. The introduction of paperless CDs will allow substantial cost savings for issuers and other users of the system.

Resolutions have been passed by a number of listed companies at their AGMs to permit the dematerialisation of their securities when the Stock Exchange's TAURUS settlement system is introduced. Many more companies may follow suit in the course of the year.