

# Financial market developments

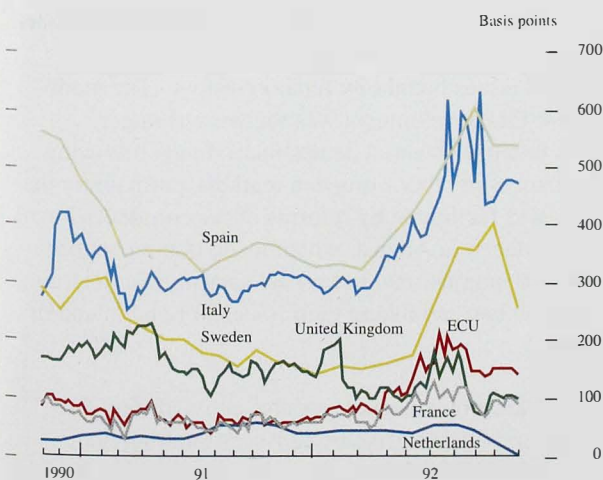
- The level of gross international debt issues was high, with OECD borrowers prominent; net borrowing in the international markets, however, remained low in the fourth quarter of 1992.
- Equity prices in some major European markets rose sharply, benefiting from currency depreciation and lower interest rates.
- Derivatives activity increased, against a background of currency and interest rate uncertainties.
- Major banks continued to report mixed performance.

## International debt markets

### Some sectors saw confidence recover . . .

Confidence recovered in some areas of the debt markets in the last quarter of 1992, particularly in high-yielding sectors of the international bond markets. Most European government bond yields declined relative to German government bonds in late October, but widened slightly when the peseta and the escudo were devalued (Chart 1). Implied volatilities for some European government bonds decreased, after rising sharply late in the summer.

**Chart 1**  
Government bond yield differentials<sup>(a)</sup>



Source: Bloomberg and Datastream.

Note: Weekly data except for the Netherlands, Spain and Sweden.

(a) Ten-year government bond yield over German bonds.

### . . . with a high level of new issues

The level of gross international bond issues was high during the fourth quarter, at \$85 billion, compared with \$69 billion a year earlier (Table A). In the eurobond and foreign bond markets, issues of fixed-rate bonds amounted to \$70 billion, eighteen per cent above the level in 1991. Net issues

remained much lower, at \$41 billion, reflecting maturities and issuers taking advantage of relatively low US dollar interest rates to refinance bonds early.

OECD governments have been prominent issuers of international bonds, with large issues by the United Kingdom, Finland, Spain and Sweden: each had earlier experienced downward pressures on their currency. Sovereign borrowers issued \$52 billion of international bonds in 1992, sixty per cent higher than in 1991 (Chart 2).

Latin American issuers have been assisted in tapping the international capital markets over the last two years by

**Table A**  
Total financing activity:<sup>(a)</sup> international markets by sector

\$ billions, by announcement date

|   | 1991<br>Year | 1992<br>Year | 1991<br>Q4  | 1992<br>Q1   | Q2           | Q3          | Q4          |
|---|--------------|--------------|-------------|--------------|--------------|-------------|-------------|
| <b>International bond issues</b>                      |              |              |             |              |              |             |             |
| Straights   | 263.5        | 278.0        | 59.7        | 88.8         | 67.5         | 51.4        | 70.2        |
| Equity-related  | 43.8         | 23.7         | 4.7         | 7.1          | 3.4          | 4.8         | 8.4         |
| of which:   |              |              |             |              |              |             |             |
| Warrants  | 31.8         | 18.4         | 3.6         | 5.3          | 2.4          | 4.4         | 6.3         |
| Convertibles  | 12.0         | 5.3          | 1.1         | 1.8          | 1.0          | 0.4         | 2.1         |
| Floating-rate notes                                   | 21.4         | 43.0         | 4.2         | 6.1          | 12.7         | 18.2        | 6.0         |
| Bonds with non-equity warrants (currency, gold, debt) | 1.0          | 1.1          | 0.6         | 0.4          | 0.3          | 0.2         | 0.2         |
| <b>Total</b>  | <b>329.7</b> | <b>345.8</b> | <b>69.2</b> | <b>102.4</b> | <b>83.9</b>  | <b>74.6</b> | <b>84.8</b> |
| <b>Credit facilities (announcements)</b>              |              |              |             |              |              |             |             |
| Euronote facilities                                   | 95.9         | 113.0        | 26.5        | 19.6         | 25.8         | 29.8        | 38.0        |
| of which:   |              |              |             |              |              |             |             |
| CP  | 38.3         | 21.5         | 10.2        | 4.0          | 2.9          | 3.0         | 11.6        |
| MTNs  | 56.0         | 90.6         | 16.2        | 15.5         | 22.3         | 26.6        | 26.3        |
| NIFs/RUFs   | 1.6          | 0.9          | 0.1         | 0.1          | 0.6          | 0.2         | 0.1         |
| Syndicated credits                                    | 136.7        | 222.0        | 37.4        | 0.1          | 79.8         | 65.3        | 48.2        |
| <b>Total</b>  | <b>232.6</b> | <b>334.1</b> | <b>63.9</b> | <b>47.8</b>  | <b>105.6</b> | <b>95.1</b> | <b>86.2</b> |

Memo: amounts outstanding

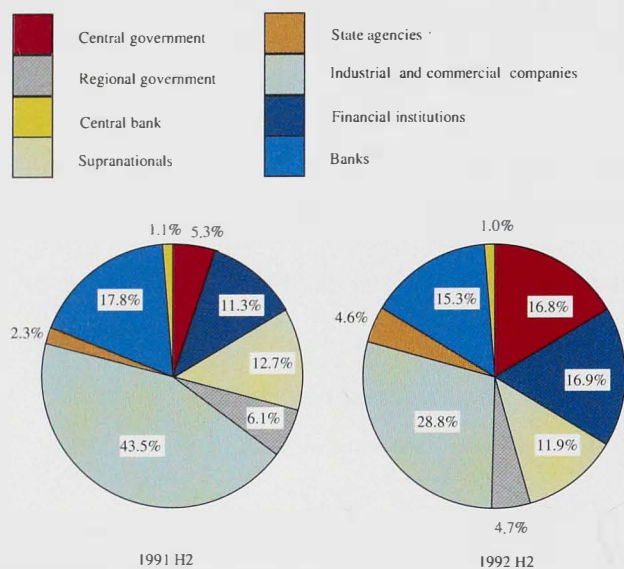
|  | 1991    | 1992    | 1991    | 1992    | 1991    | 1992    |
|--|---------|---------|---------|---------|---------|---------|
| All international Bonds <sup>(b)</sup> | 1,648.3 | 1,686.0 | 1,648.3 | 1,607.1 | 1,707.9 | 1,767.0 |
| Euronotes <sup>(c)</sup>               | 144.9   | 173.1   | 144.9   | 156.2   | 166.5   | 174.9   |
| of which, EMTNs                        | 38.5    | 61.4    | 38.5    | 41.0    | 47.5    | 53.7    |

(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. Bond total includes issues from MTN programmes.

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

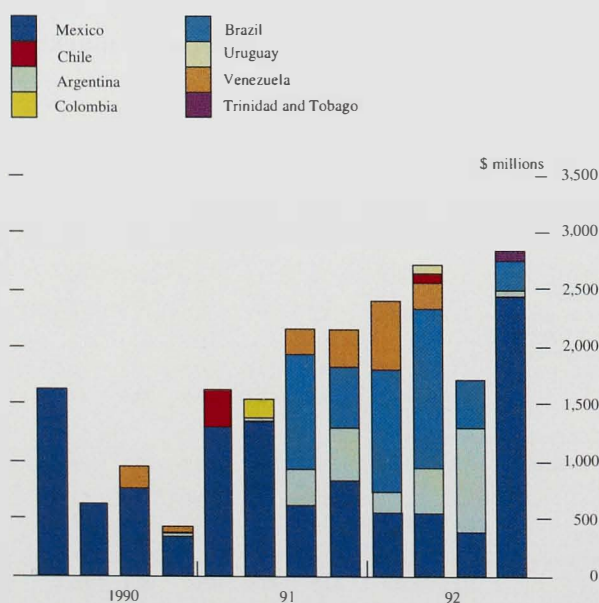
(c) Euroclear figures.

**Chart 2**  
Announced international bond issues by sector



reforms and improvements in their domestic economies and the attraction of higher yields to some investors. Issues of Latin American bonds and equity rose in the fourth quarter, with top-quality Mexican borrowers prominent (Chart 3). The large volume of Latin American bonds already in the market and a political impeachment vote in Brazil may have deterred other issuers. In some cases, spreads widened and deal sizes were reduced. Higher quality Latin American borrowers have been offering innovative instruments, making use of euromedium-term notes, eurocommercial

**Chart 3**  
Latin American international bond issues



Source: Bank of England ICMS database.

paper and the US domestic bond market. One Mexican issuer launched bonds backed by oil receivables. Mexican banks have been active issuers of eurocommercial paper since restrictions were imposed on their foreign currency CD issues.

*The deutschmark, Swiss franc and sterling sectors were particularly active*

The currency composition of fixed-rate international bonds shifted from the US dollar during the fourth quarter

**Table B**  
Currency composition of fixed-rate bond issues<sup>(a)</sup>

Percentage of total issues announced

| Currency denomination | 1990       | 1991       | 1992       |            |            |
|-----------------------|------------|------------|------------|------------|------------|
|                       | Year       | Year       | Year       | Q3         | Q4         |
| US dollar             | 30         | 29         | 32         | 43         | 30         |
| Ecu                   | 10         | 12         | 7          | 0          | 0          |
| Deutschmark           | 4          | 5          | 11         | 7          | 19         |
| Swiss franc           | 9          | 5          | 5          | 7          | 8          |
| Sterling              | 6          | 7          | 7          | 6          | 8          |
| Canadian dollar       | 4          | 10         | 6          | 6          | 1          |
| Yen                   | 18         | 15         | 14         | 14         | 17         |
| French franc          | 5          | 6          | 8          | 7          | 10         |
| Italian lira          | 3          | 3          | 2          | 1          | 0          |
| Other                 | 11         | 8          | 8          | 9          | 7          |
| <b>Total</b>          | <b>100</b> | <b>100</b> | <b>100</b> | <b>100</b> | <b>100</b> |

(a) Excluding equity-related issues.

(Table B). Gross US domestic bond issues also fell from their high level earlier in the year, but reached record levels in early 1993.

There was quite rapid growth in fixed-rate bond issues in deutschmarks, which accounted for 19% of such issues in the fourth quarter, well up from 5% in 1991. Several large issues (for DM 1 billion or more) were launched for high-quality borrowers using the fixed-price re-offer mechanism which has become the standard launch and pricing technique for comparable issues in other currencies. Prominent among these were issues for Sweden, the United Kingdom and, most recently, Italy. The UK bond was the largest ever fixed-rate deutschmark eurobond.

These very large issues are targeted at institutional investors, unlike traditional eurodeutschmark bonds which were mostly small issues bought by retail investors. The main stimulus for this development was the wish of major borrowers to tap substantial deutschmark funds following the disturbances in other European markets, particularly the Ecu. This was facilitated by reforms of the eurodeutschmark market introduced in August, which made issues cheaper and easier for international borrowers accustomed to issuing under English law and listing their issues in London and/or Luxembourg.

The Swiss franc bond market was also active during the fourth quarter, with new fixed-rate issues totalling the equivalent of \$6 billion, more than twice the level in the fourth quarter of 1991. Issuers benefited from very low absolute yields, while investors were attracted by the currency's 'safe haven' status outside the ERM. The Swiss bond and equity markets strengthened in December after the vote against joining the European Economic Area, which was interpreted as further separating the Swiss markets from uncertainties within the European Community.

The sterling sector took its largest share of fixed-rate international bond issues since the first half of 1991, with lower short-term sterling interest rates encouraging

issues of high-quality sterling debt. Much of the debt was of around five years' maturity, as issuers took advantage of the sharp fall in short yields relative to long yields and increased swap opportunities arising from greater volatility in interest rates and exchange rates.

The IBRD announced its first sterling bond issue for nearly two years, which was swapped immediately into deutschmarks, and the largest ever single fixed-rate issue was made in November by the Kingdom of Sweden for £600 million (subsequently increased to £800 million), providing a new five-year benchmark. In the financial sector, National Westminster Bank announced the first issue by a UK bank in the sterling bond market of Tier 2 capital which is convertible into Tier 1 capital.

#### *Ecu trading continued to be subdued*

Ecu markets remained subdued in November and December, with trading volumes low. Nevertheless, Ecu bonds outperformed those in component currencies in broad terms and conditions in Ecu money markets also improved. January saw a marked improvement in sentiment in both areas.

The Bank held regular monthly Ecu Treasury bill auctions as usual, subject to maximum yields announced on the day of the auction, which continued to be set at around ten basis points below Libid. Bidding at auctions improved as confidence revived. At the January auction, ECU 765 million were sold and the one and three-month bills were oversubscribed.

The Bank has also continued to sell bills not subscribed at tender in the secondary market, at somewhat wider spreads below Libid. Such sales amounted to ECU 1,420 million in the three months to the end of January. At that stage, official holdings were at their lowest since October, at a total of ECU 310 million of the two bills dated May and June.

#### *The UK foreign currency borrowing programme was completed*

The ECU 10 billion programme of foreign currency borrowing announced by the UK Government on 3 September was completed with a \$3 billion ten-year eurodollar bond announced on 30 November. As with the DM 5 billion eurodeutschmark bond announced on 20 October, part of the same programme, the eurodollar bond was issued via an international underwriting syndicate, using the fixed-price re-offer method. It is the largest bond of its type and is designed to provide a highly liquid alternative to domestic government bonds. Both bonds were well received and have been among the most actively traded issues in the international markets.

#### *Equity-linked bond issues were higher, but below 1991 levels*

The value of equity-linked bond issues in the international markets rose to \$8.4 billion in the fourth quarter, although the total for 1992 was about half the level of 1991, reflecting

investors' reluctance to take a long-term positive view of the Nikkei, to which most equity-related international bonds have been linked. In the domestic Italian market, however, several medium-term credit institutions have issued bonds linked to major stock indices to obtain funds at rates below Libor (although these issues may partly be tax driven).

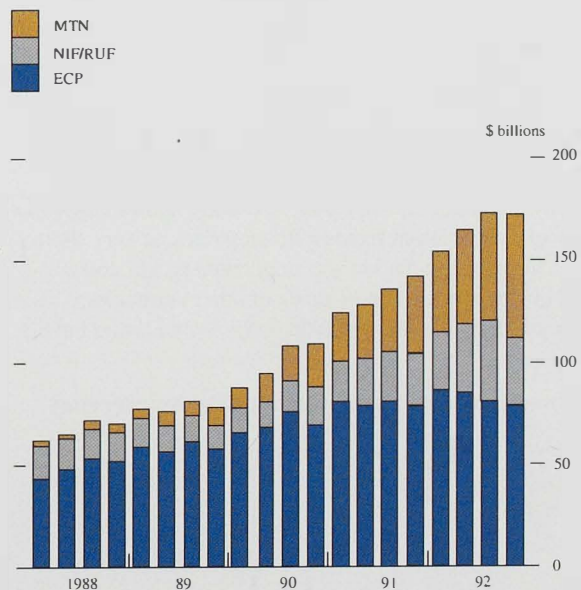
#### *FRN issuance fell*

The level of floating-rate note issues, at \$6 billion, was half that in the second quarter, and only a third of that in the third quarter. A reduction in Tier 2 capital issues by the banking sector (especially by Japanese banks) was a major contributory factor. A widening of dollar swap spreads also enabled some borrowers to obtain funds more cheaply by issuing fixed-rate dollar bonds and swapping them into floating-rate debt at rates below Libor.

#### *The EMTN market continued its growth*

The euromedium-term note market continued to flourish in the fourth quarter (Chart 4), with net new issues totalling \$7.7 billion. Financial institutions in OECD countries have still been the most active borrowers, but a few borrowers from developing countries (including Mexico and Korea)

**Chart 4**  
**Stock of outstanding euronotes**



Source: Euroclear.

have also established programmes. The value of eurocommercial paper outstanding has remained broadly level at around \$80 billion over the last two years. Major borrowers may have reached their desired levels of borrowing, and there has been weak demand for further working capital.

#### **International equity markets**

##### *Equity prices rose sharply in some markets*

Equity prices in the major markets, particularly in Europe, followed diverging paths during the last quarter of 1992

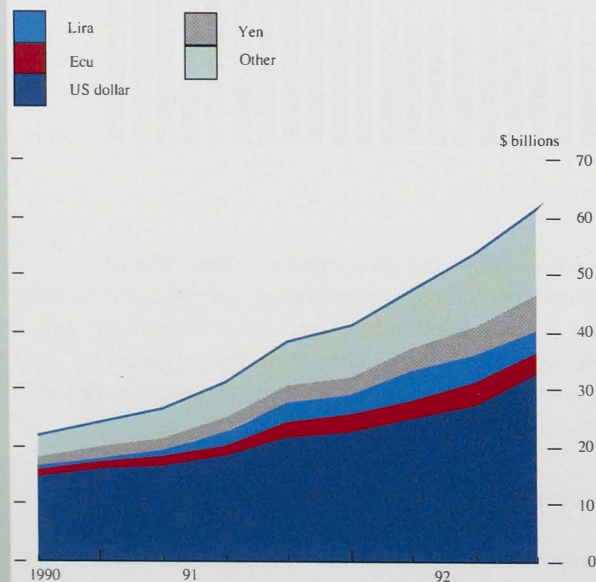
## Euromedium-term notes

Over the last two years, the euromedium-term note (EMTN) market has grown rapidly, with outstanding issues rising some threefold to \$61 billion. EMTN programmes were first arranged in the euromarkets in 1986, more than twenty years after eurobonds were first issued in London. Although the eurobond market is far larger (outstanding issues total \$1,321 billion), EMTNs are increasingly being seen as a more flexible and competitive funding tool. The range of issuers in the EMTN market has expanded from state borrowers and financial institutions to include non-financial companies, supranational institutions and borrowers from non-OECD countries such as Mexico, Korea and Venezuela. Among UK institutions, the large building societies are particularly prominent EMTN issuers.

EMTNs are debt securities which are typically issued under continuously offered programmes. To date, most issues have had a maturity of around two to five years, although longer-dated issues are becoming more common. Maturities can be as short as one month or as long as thirty years. Programme sizes varied in 1992 from \$50 million to \$5 billion. Individual issues are usually for between \$2 million and \$10 million, but larger issues—for between \$50 million and \$250 million—are becoming more common as underwritten EMTN issues, which are more akin to eurobonds, become more popular. Underwritten EMTN issues (in which borrowers are guaranteed funds) were first made in 1991 and there were some forty issues in 1992. Around one third of these issues were syndicated using the fixed-price re-offer method.

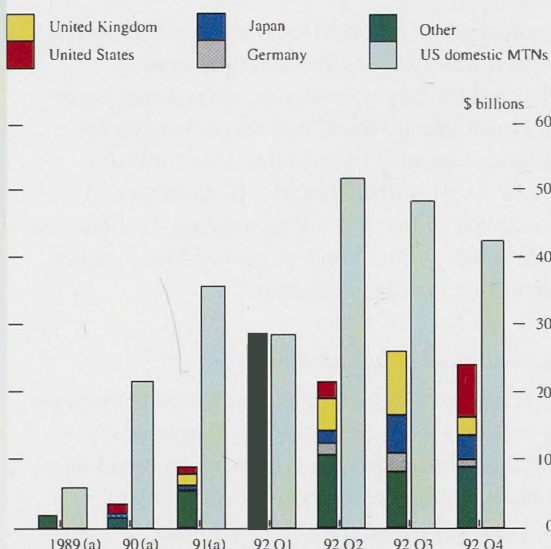
The programme documentation sets out the common terms under which notes may be issued, thus increasing the speed with which an issue can be made. It usually allows issues in a variety of currencies, at fixed or floating rates, at very short notice. Initially, the market was dominated by US dollar issues, but greater use is now made of other currencies, particularly Ecu, lira and yen (Chart A). Debut issues have

**Chart A**  
Euromedium-term notes outstanding, by currency



Source: Euroclear.

**Chart B**  
EMTN and US MTN programme announcements



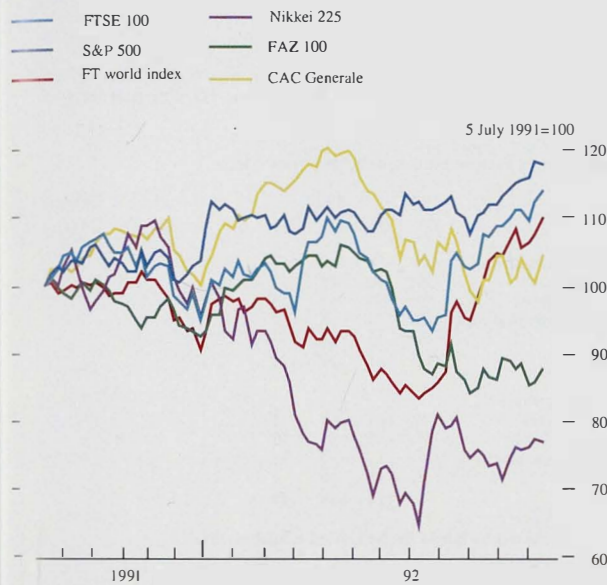
Source: Bank of England ICMS database and Securities Data Corporation.  
(a) Quarterly equivalent.

been made in the last two years in Danish kroner, deutschmarks, Irish punts and Swedish kroner.

Growing currency diversity is linked in some cases to deregulation (for example, in the deutschmark and Finnish markka sectors) and also, more generally, to the growing sophistication and increased awareness of the borrower and investor base. As the market has developed (and as US interest rates have fallen), investors may have been attracted to higher-yielding non-dollar paper. Issuers have used a variety of currencies to try to benefit from swap opportunities; to widen their investor base; to meet small currency funding demands which cannot be satisfied in the public bond market; and, in some cases, to respond to the particular structured financing needs of certain investors. Such structured issues are becoming increasingly common and are fostered by a close relationship between borrowers, dealers and investors which, combined with their relatively small size, makes them more akin to private placements than public issues.

In the United States, where MTNs have been issued since 1981, the market plays a major role in fund raising by companies and other entities, accounting for around 40% of investment grade public debt issues in 1991. Last year, total US MTN programme announcements were \$188 billion, compared with \$101 billion EMTNs (Chart B). Growth of the US MTN market has been helped by investors' willingness to purchase issues with relatively long maturities and to accept a wide range of credit quality. Foreign borrowers occasionally establish domestic MTN programmes in the United States or 'global' note programmes, which permit borrowing in the United States and euromarkets. A few lower-rated European borrowers, for example, have issued US MTNs through 144a private placements as an alternative to issuing in the euromarkets, where costs may have been higher and where it may have been more difficult to obtain the desired maturity.

**Chart 5**  
Equity indices<sup>(a)</sup>



(a) End-week prices.

(Chart 5). Prices rose sharply in Finland, Italy, Spain, Sweden and the United Kingdom, in anticipation of the effects of actual and expected reductions in interest rates and of currency depreciation on economic growth and corporate earnings. Tight monetary policy and slower activity subdued equity prices in France, Germany and the Netherlands.

The US equity market rose slightly in the last quarter of 1992, reflecting favourable economic indicators and the resolution of uncertainties over the presidential election. Low interest rates have encouraged investors to switch funds into the equity market, with US corporations raising \$94 billion of equity in the year to November 1992, 40% more than in 1991. Investment in equity-based mutual funds over the year to November 1992 was double the level in the previous year.

In Japan, the equity market traded in a narrow range in the fourth quarter. The financial and fiscal packages announced in August by the government led initially to a sharp rise in equity prices, but the Nikkei then drifted down; in 1992 overall, it fell by 20%. The Hong Kong stock market, which had risen by more than 40% in the first half of 1992, fell during the rest of the year owing largely to uncertainties over the colony's future.

## International derivatives markets

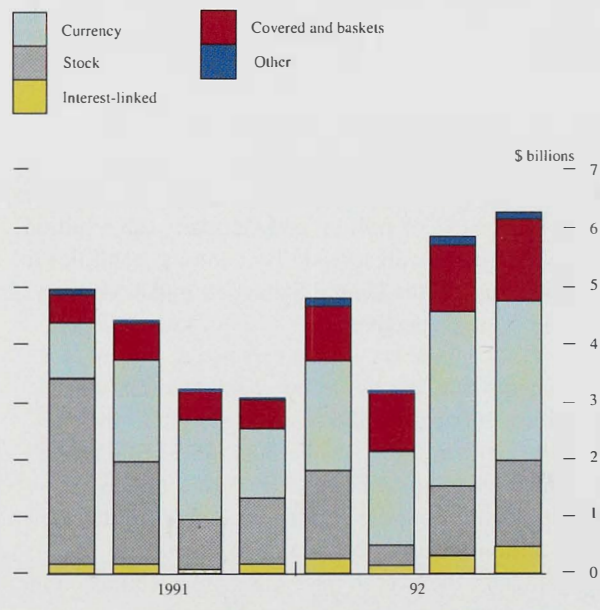
### *Market uncertainties contributed to a high level of activity*

Continuing market uncertainty over currency and interest rates in Europe appears to have contributed to the strength of activity in related derivatives markets. Activity in European and US futures markets grew especially strongly in the second half of the year. Three London futures exchanges (LIFFE, the International Petroleum Exchange and the

London Metal Exchange) achieved record annual turnover in 1992, with exceptionally high activity in the third quarter. In Japan, however, volumes fell in the fourth quarter, particularly as trading in the Nikkei 225 stock index future moved to the Singapore exchange (SIMEX).

In the over-the-counter (OTC) public warrant market, announced total premium income (\$12.2 billion) in the second half of 1992 was nearly twice the level of the comparable period in 1991. Stock and currency options showed a marked rise (Chart 6).

**Chart 6**  
Public 'over-the-counter' warrants



In the United States, legislation re-authorising the Commodity Futures Trading Commission gave it formal powers to exempt swaps and other derivatives from its supervision. Various studies of derivatives by regulators in the United States and elsewhere have been announced. The market has continued to address concerns about credit quality, related to the growth of derivatives business. For example, several international banks and securities firms have established, or are considering, separately capitalised special purpose vehicles for derivatives activity to enable them to compete more effectively, particularly in the credit-sensitive (long-term) swaps market.

## Banking sector

### *Banks' performance continued to be mixed*

Concerns over credit quality continued to affect a number of major international banks, securities houses and insurance companies in France, Japan, Scandinavia and the United Kingdom. In the United Kingdom, a number of large banks reported poor results, reflecting the deepening of the recession.

US banks raised twice as much domestic debt in 1992 (\$15.5 billion) as in 1991 and continued to improve their

## International banking developments

### The London market—third quarter 1992

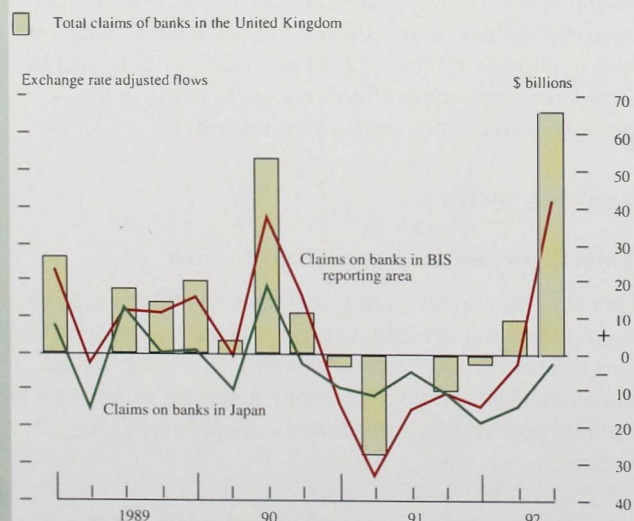
Total cross-border business of banks in the United Kingdom increased sharply on both sides of the balance sheet during the third quarter (mainly at the time of the turbulence in the currency markets in September), in contrast with the depressed level of activity earlier in the year. Liabilities and claims rose by \$54.1 billion and \$67.1 billion respectively, reflecting sharp increases in interbank business with banks within the BIS reporting area. The net flow of \$13 billion was largely owing to net sterling lending of \$9.8 billion.

Within the BIS reporting area, the rise in interbank liabilities of \$36.2 billion was more than accounted for by UK banks' liabilities to banks in other European countries, notably France (\$13.8 billion) and Germany (\$8.6 billion), with the remainder well spread. By contrast, liabilities to banks in Japan and the United States fell by \$4.5 billion and \$3.6 billion respectively.

On the claims side, the rise in interbank lending of \$42.1 billion related mainly to lending to banks in Germany (\$10.7 billion), Switzerland (\$8.5 billion) and the United States (\$6.1 billion). UK banks' claims on banks in Japan fell for the eighth successive quarter, down by \$2.9 billion. Sterling business accounted for \$20.3 billion of the overall rise. UK banks' claims on the non-bank sector also increased, notably on Germany (\$8.7 billion) and Sweden (\$5.5 billion).

Outside the BIS reporting area, the largest movement was a fall in liabilities of \$4.2 billion to oil exporting countries, reflecting a decline in deposits from Saudi Arabia of \$5.1 billion. Elsewhere business remained relatively flat.

### External lending of banks in the United Kingdom



### Cross-border business of banks in the BIS reporting area

\$ billions: changes exclude estimated exchange rate effects

|   | 1991        |              | 1992         |            | Levels at end Q3 | Changes Q4 (a) |
|---|-------------|--------------|--------------|------------|------------------|----------------|
|   | Q3          | Q4           | Q1           | Q2         |                  |                |
| <b>Liabilities to countries</b>                               |             |              |              |            |                  |                |
| BIS reporting area  | -36         | 40           | -48          | -52        | ..               | ..             |
| of which, interbank   | -36         | 50           | -63          | -53        | ..               | ..             |
| Outside BIS reporting area                                    | 10          | 3            | -8           | 2          | ..               | ..             |
| Unallocated   | -5          | 18           | 27           | 13         | ..               | ..             |
| <b>Total</b>  | <b>-32</b>  | <b>61</b>    | <b>-29</b>   | <b>-37</b> | ..               | ..             |
| <b>Claims on countries</b>                                    |             |              |              |            |                  |                |
| BIS reporting area  | -8          | 104          | -55          | -35        | ..               | ..             |
| of which, interbank   | -28         | 85           | -79          | -67        | ..               | ..             |
| Outside BIS reporting area                                    | 6           | 17           | 10           | 15         | ..               | ..             |
| Unallocated   | -2          | -8           | 8            | 3          | ..               | ..             |
| <b>Total</b>  | <b>-4</b>   | <b>114</b>   | <b>-38</b>   | <b>-17</b> | ..               | ..             |
| <b>Of which transacted by banks in the United Kingdom (b)</b> |             |              |              |            |                  |                |
| <b>Liabilities to countries:</b>                              |             |              |              |            |                  |                |
| BIS reporting area  | 5.5         | -6.0         | -16.5        | -10.1      | 41.3             | 873.0          |
| of which, interbank   | -0.6        | -0.1         | -13.7        | -4.5       | 36.2             | 569.1          |
| Outside BIS reporting area                                    | 2.1         | -2.5         | -0.8         | 4.0        | 0.8              | 175.1          |
| Unallocated   | -7.8        | 3.9          | 2.1          | 8.1        | 12.0             | 121.1          |
| <b>Total</b>  | <b>-0.2</b> | <b>-4.6</b>  | <b>-15.2</b> | <b>2.0</b> | <b>54.1</b>      | <b>1169.2</b>  |
| <b>Claims on countries:</b>                                   |             |              |              |            |                  |                |
| BIS reporting area  | -3.9        | -7.6         | -7.6         | 0.7        | 57.3             | 924.6          |
| of which, interbank   | -15.3       | -10.5        | -16.9        | -2.7       | -42.1            | 629.1          |
| Outside BIS reporting area                                    | -0.6        | -0.5         | 3.3          | 0.9        | 0.8              | 114.7          |
| Unallocated   | 3.3         | -2.4         | 1.0          | 8.1        | 9.0              | 26.2           |
| <b>Total</b>  | <b>-1.2</b> | <b>-10.5</b> | <b>-3.3</b>  | <b>9.7</b> | <b>67.1</b>      | <b>1065.5</b>  |
| <b>UK claims by currency</b>                                  |             |              |              |            |                  |                |
| US dollar   | -3.9        | -8.5         | -8.1         | 7.8        | 11.1             | 481.5          |
| Deutschmark   | 0.5         | -10.9        | -0.1         | -2.6       | 22.5             | 180.3          |
| Sterling  | -2.6        | -2.6         | 1.1          | 6.3        | 23.0             | 107.5          |
| Japanese yen  | -0.6        | -11.7        | -3.5         | -11.6      | -3.9             | 82.6           |
| <b>UK claims by nationality of bank (a)</b>                   |             |              |              |            |                  |                |
| Japanese  | -15.1       | -7.8         | -26.4        | -12.0      | -13.1            | 257.3          |
| British   | 3.5         | 0.9          | 2.9          | 3.0        | 16.0             | 171.0          |
| American  | 1.0         | -1.9         | 0.7          | -2.4       | -3.0             | 107.0          |
| German  | 5.8         | 2.1          | 4.1          | 3.7        | 21.5             | 136.9          |
| French  | 0.4         | 0.0          | 3.5          | -2.5       | 11.0             | 51.1           |
| Italian   | 0.4         | 2.9          | -0.6         | 1.7        | 5.3              | 88.1           |

.. not available. Figures will be published on 26 February 1993 by the Bank for International Settlements in a press release titled 'International banking and financial market developments'.

(a) Q4 changes are provisional. Nationality and Q4 changes only relate to monthly reporting banks.

(b) Also includes some other financial institutions. More details by country and currency are given in a press release issued on 22 December 1992.

### Provisional data for the fourth quarter of 1992

Provisional data for the fourth quarter show that the cross-border business of banks in the United Kingdom continued to increase, with liabilities up by \$33 billion and claims up by \$19 billion. Total international liabilities and assets (including foreign currency business with UK residents) rose by \$27 billion and \$18 billion respectively.

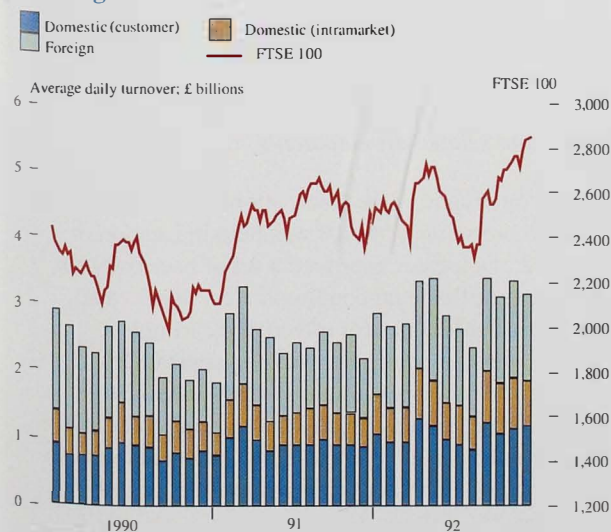
Business with own offices overseas and overseas investments both grew strongly in the fourth quarter. In the cross-border interbank market, liabilities rose by \$12 billion, while assets fell by the same amount. Japanese and American banks increased their international business, reversing the trend of recent quarters. British banks' business remained broadly level, while other EC banks' business fell, with liabilities and claims down by \$13 billion and \$10 billion respectively.

profits in the second half of 1992, helped by further widening of spreads and buoyant trading revenue. US bank lending to the commercial and industrial sector rose slightly, but remained below the levels of 1991. Lending by banks in Japan is slowing and there has been a reassessment of the banks' own credit quality, reflected in a number of downgradings of credit ratings. In Germany, lending to the non-bank sector has continued to grow steadily and the major banks reported strong profitability in 1992. In France, the level of banks' non-performing property loans prompted the French Bankers' Association to call for state intervention through cheap loan refinancings. Official action had earlier been taken in Japan and Scandinavia to help with banks' problems over property lending.

Concerns over asset quality appear to have encouraged many European banks, irrespective of size, to focus primarily on consolidating their domestic positions. In southern Europe, some smaller banks continued to forge cross-border links ahead of the official opening of the single market on 1 January 1993, but the motivation may have been mainly defensive. The Japanese bank sector has continued to retrench internationally, closing some overseas operations and further curtailing international interbank lending.

Banks have, however, increased their activity in the Far East and Asia (excluding Japan), stimulated by deregulation and rapid economic growth in the region. Cross-border bank lending to the area has increased over the past few years, in contrast with lending to Latin America and Africa, and banks have also been increasing their physical presence. The non-Japanese Asian region has also been increasing its participation in international capital markets. In the fourth quarter, the Asian Development Bank launched its second 'dragon' bond (lead-managed in Hong Kong and placed largely in the non-Japan Asia region). International bonds issued in London and continental Europe are also increasingly receiving wide placement in the non-Japan Asia region, absorbing some of the large pool of investment funds resulting partly from strong economic growth.

**Chart 7**  
Equity turnover and prices on the London Stock Exchange



## UK markets

### New issues activity was fairly buoyant

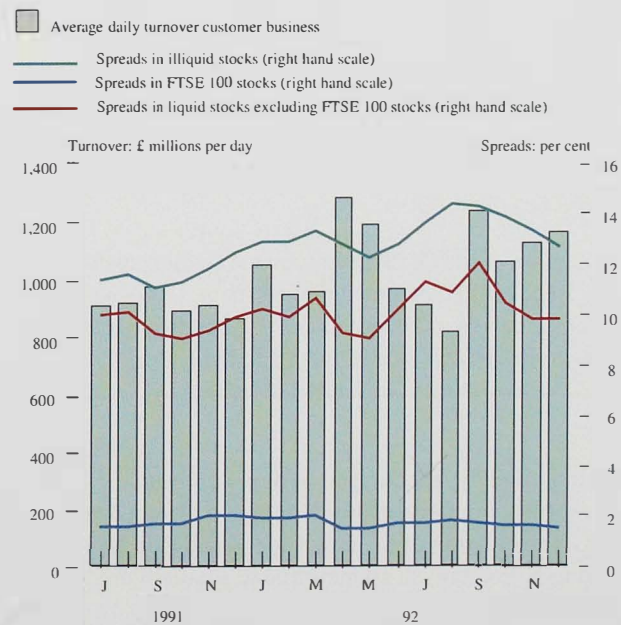
The sharp rise in equity prices in the fourth quarter (Chart 7), following sterling's depreciation and successive base rate cuts, enabled a number of companies to make new issues. The value of new equity issues announced by UK borrowers rose to £2.1 billion, the highest level since the third quarter of 1991. Over half of this total was accounted for by the two largest issues, one of which related to an agreed takeover bid. The number of rights issues fell in the fourth quarter, although the value raised increased (Table C).

**Table C**  
Announcements of rights issues

|               | Number of issues | Value<br>£ millions |
|---------------|------------------|---------------------|
| 1991<br>Total | 192              | 10,305              |
| 1992          |                  |                     |
| Q1            | 31               | 1,555               |
| Q2            | 33               | 935                 |
| Q3            | 17               | 375                 |
| Q4            | 16               | 1,485               |
| Total         | 97               | 4,350               |

In the secondary market, daily customer turnover in UK equities held up, averaging some £1 billion, while average dealing spreads narrowed (Chart 8). The introduction of two new indices (see November *Quarterly Bulletin* page 406 for details) increased interest in second-line stocks, which are expected to be earlier beneficiaries of a UK recovery than

**Chart 8**  
Average spreads and turnover



Source: Stock Exchange.

FTSE 100 stocks. The London Stock Exchange has published a consultative document setting out its plans to abolish the Unlisted Securities Market (USM), which has lost much of its attraction relative to the Official List during the last few years. Under the Stock Exchange's plans, the USM would be phased out by the end of 1995. USM

## London futures markets: growth, diversity and internationalism

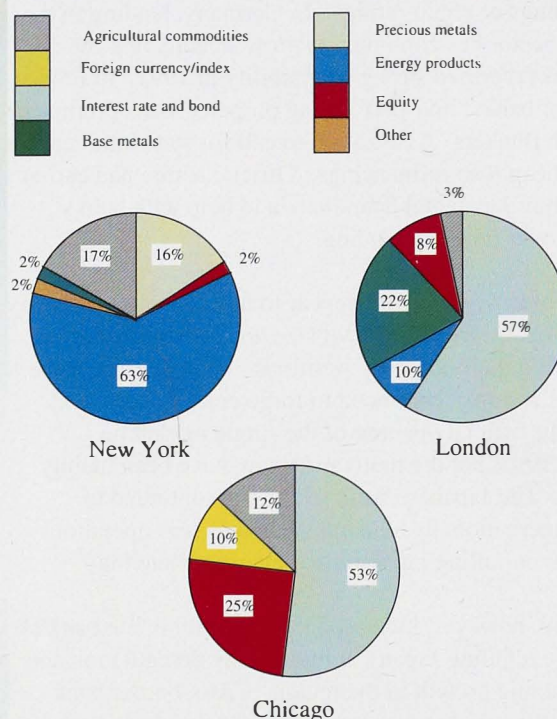
The rapid growth in turnover on London's futures and options markets reached a peak on 16 September 1992, when trading on LIFFE for the first time exceeded that on the longer-established Chicago exchanges, which pioneered the development of financial futures and options. London now offers a greater diversity of financial and commodity contracts than either Chicago or New York, reflecting the breadth of its underlying international banking, securities and commodities business. The chart opposite shows a sectoral breakdown of contracts traded in each centre.

The international contracts traded on LIFFE cover UK, German, Italian, Japanese, Swiss, US and Ecu bonds and interest rates. Three new contracts have been added during the last year: a three-month eurolira future, an option on the euroswiss franc future and, from 21 January, the medium-term German government bond future (the exchange's fifth German contract).

The commodity futures markets are more mature than their financial counterparts and the pace of product innovation is slower. The aluminium alloy future introduced by the London Metal Exchange (LME) in October 1992 was its first new contract for over ten years. Trading volumes of LME contracts increased sharply during 1992, however, with wider international participation. Over 95% of the exchange's business now comes from overseas and three quarters of the exchange's member companies are foreign-owned. The LME is unusual in having no direct rival in the international markets. Other non-ferrous metal markets are essentially domestic. The International Petroleum Exchange (IPE) draws more than 60% of its business from overseas. Trading volume on the IPE rose by over one quarter in 1992.

The launch of the GLOBEX automated trading system in June 1992 further extended the international focus of the London markets. The system, developed by Reuters, the Chicago Board of Trade (CBOT) and the Chicago

Trading volumes of London, New York and Chicago futures and options exchanges, by contract sector, 1992<sup>(a)</sup>



(a) Contracts accounting for less than 2% of total turnover are included in 'other'.

Mercantile Exchange (CME), allows CBOT and CME contracts to be traded on screens in London, Chicago, New York and Paris, during most hours when the Chicago exchanges' floor-based markets are closed. LIFFE has its own automated trading system which runs exclusively in London as a largely out-of-hours adjunct to floor-based trading. It has, however, expressed interest in joining GLOBEX to enable its contracts to be traded in other time zones when London markets are closed. The London Futures and Options Exchange (FOX) also has its own automated system, used in London in conjunction with floor trading but with the capability of use overseas. In 1992, the IPE announced that it was studying various options for automation.

companies would be encouraged to move up from the USM to the List (the alternative being to move to matched bargain trading). The creation of the new FTSE Small Cap Index is intended to help establish an identifiable smaller companies sector on the List.

SEATS, the Stock Exchange's new alternative trading system for less liquid stocks, made a satisfactory start, coping well with the business generated by the annual round of New Year stock selections. Liquidity in smaller companies has, however, remained poor, with high spreads observed in some SEATS stocks. Another firm withdrew from market making in smaller company stocks.

### Regulatory and related developments

The annual conference of the International Organisation of Securities Commissions (IOSCO) was held in London in October 1992. Delegates approved a set of principles for the supervision of financial conglomerates. IOSCO also released a set of guidelines for effective clearing and settlement systems in emerging markets, approved a recommendation for review of anti-money laundering measures in the securities industry and endorsed the use of the International Standards on Auditing as an acceptable basis for use in cross-border offerings and reporting by foreign issuers.



The Formation Committee set up by the Securities and Investments Board to help establish the Personal Investment Authority (PIA), a new self-regulating organisation to cover retail business, announced in November a shadow board for the new body. The board was chaired by Sir Gordon Downey and included representatives from life companies and independent financial advisers, as well as a bank and a building society. The body, with the addition of two further members, was confirmed in January as the board for the newly-incorporated PIA.

A new body, the Financial Law Panel has been formed to act as the central forum for the consideration of problems of legal uncertainty in so far as they affect the UK wholesale financial markets. This was proposed by the Legal Risk Review Committee in October in its report to the Governor of the Bank of England. The Panel will also review relevant proposals for legislation and regulation and make proposals for law reform to secure the more efficient functioning of those markets. The Bank of England and the Corporation of London will act as co-sponsors. Lord Donaldson will be the Panel's first chairman.

The Cadbury Committee on the financial aspects of corporate governance published its final report on 1 December 1992. Reactions to the report and to the code of best practice which it proposes have so far been generally favourable. The Committee's proposals on compliance are seen as preferable to a statutory alternative. The Committee recommends that listed companies reporting in respect of

years ending after 30 June 1993 should state in their report and accounts to what extent they comply with the code and explain any areas of non-compliance. Such statements should be reviewed by the auditors before publication and should become a continuing obligation of listing by the London Stock Exchange.

The President of the Board of Trade announced on 21 December that the Government had decided, in principle, to act as reinsurer of last resort for terrorist attacks against mainland non-domestic property and related risks with effect from 1 January 1993. It has become increasingly difficult in recent months for insurers operating in the United Kingdom to obtain the reinsurance protection they need to enable them to continue to offer terrorism cover for new policies and renewals from the end of 1992. The announcement means that owners and tenants of industrial and commercial property should continue to be able to obtain cover against terrorist attacks, although the price of such cover will be adjusted to reflect the changes in the risk in the usual way. The announcement does not, however, mean that the Government will pay compensation to businesses who are uninsured for terrorist risks.

The six bank owners of the London Clearing House, which clears and guarantees the contracts of the London futures exchanges, agreed in January 1993 to provide it with a new standby facility of £150 million, which came into effect on 1 February. The facility replaced previous arrangements comprising a standby line and insurance.