Financial market developments

Overview

Despite the weak economic environment, the upward trend in the level of international capital market financing showed signs of continuing in the second quarter, although activity was lower than in the record first quarter. A range of contrasting influences led to differences in the performance of market segments.

Several factors kept activity high. International bond issues were boosted by the large funding requirements of sovereign borrowers—to finance deepening fiscal deficits or to replenish foreign exchange reserves—and of companies needing to refinance maturing debt. And the easing of long-term interest rates stimulated financing or refinancing activity in longer-term instruments, although at the expense of issues of short-term paper. Borrowers from Latin America and the buoyant Asian economies also contributed to the high level of activity. The reduction in exchange market tensions in Europe stimulated issues in a variety of currency sectors, and led to a sharp fall in issues in the deutschmark, which had dominated European issues in the second half of last year.

The long-term growth of activity in securities markets at the expense of banking markets has reflected the increase in institutional portfolio management and continuing deregulation, both of which have boosted cross-border investment and asset diversification. At the same time, banks' business has been influenced by their cautious and selective approach towards new lending. These factors continued to have a major effect during the second quarter. Large loss provisions and the implementation of the new capital adequacy guidelines have caused Japanese banks to remain cautious about increasing their international exposures, other than to Asian borrowers. And although US banks' earnings have recovered, they are only gradually taking a more positive attitude towards lending opportunities. A significant part of the rise in syndicated credit activity in the second quarter reflects the refinancing of existing debt by US companies, typically arranged by US banks, rather than a net increase in their exposures.

International capital markets

Issuance boosted by refinancing

The upward trend in international bond market issues continued in the second quarter of 1993, as Table A shows. Activity was around one third higher than a year earlier, although down on the record first quarter level. Refinancing requirements remained one of the main factors driving the level of international bond market issues. Net of redemptions and early repayments, bond issues in the second quarter were only 12% higher than a year earlier (see Chart 1).

Table A
Total financing activity:[a] international markets by sector

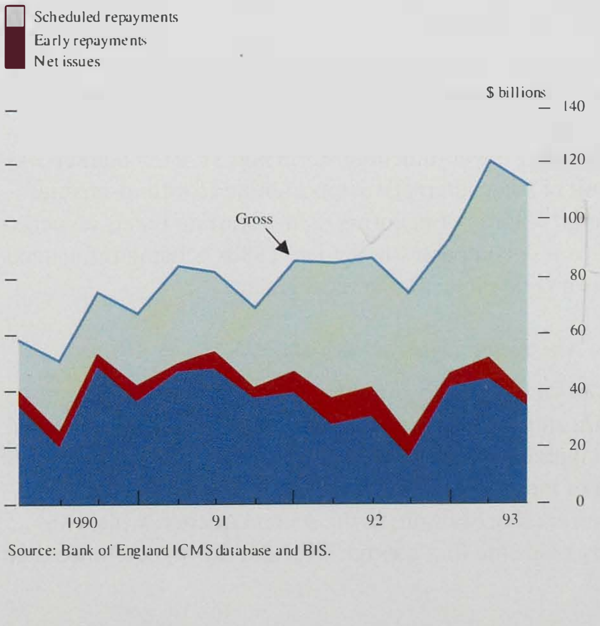
$ billions, by announcement date

	1991	1992				1993	
	Year	Year	Q2	Q3	Q4	Q1	Q2
International bond issues							
Straights	263.1	281.5	67.5	51.6	73.6	122.3	88.1
Equity-related	43.8	24.0	3.4	4.8	8.8	8.6	8.3
of which:							
Warrants	*31.8*	*18.3*	*2.4*	*4.4*	*6.3*	*6.2*	*3.7*
Convertibles	*12.0*	*5.7*	*1.0*	*0.4*	*2.5*	*2.4*	*4.6*
Floating-rate notes	21.8	43.2	12.7	18.2	6.2	15.6	13.6
Bonds with non-equity warrants (currency, gold, debt)	1.0	1.2	0.3	0.2	0.2	0.8	0.4
Total	**329.7**	**349.9**	**83.9**	**74.8**	**88.8**	**147.3**	**110.4**
Credit facilities (announcements)							
Euronote facilities	73.0	118.6	26.0	28.2	33.1	15.1	11.5
of which:							
CP	*26.9*	*17.3*	*3.2*	*1.7*	*8.3*	*6.1*	*2.1*
MTNs	*45.8*	*100.6*	*22.2*	*26.5*	*24.7*	*9.0*	*9.2*
NIFs/RUFs	*0.3*	*0.7*	*0.5*	—	*0.1*	—	*0.3*
Syndicated credits	136.7	221.7	80.6	65.2	47.1	42.3	64.2
Total	**209.7**	**340.3**	**106.6**	**93.4**	**80.2**	**57.4**	**75.7**
Memo: amounts outstanding							
All international							
Bonds(b)	1,648.3	1,686.4	1,707.9	1,767.0	1,686.4	1,741.8	1,777.8
Euronotes(c)	144.9	173.1	166.5	174.9	173.1	182.6	199.3
of which, EMTNs	*38.5*	*61.4*	*47.5*	*53.7*	*61.4*	*77.8*	*94.8*

(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.

New issues of fixed-rate bonds accounted for 80% of total bond offerings in the second quarter. Floating-rate note issues (FRNs), which had risen sharply last year, remained strong. And the market for equity-linked bonds stabilised after a marked recovery from the depressed level of a year ago.

Chart 1
International bond issues

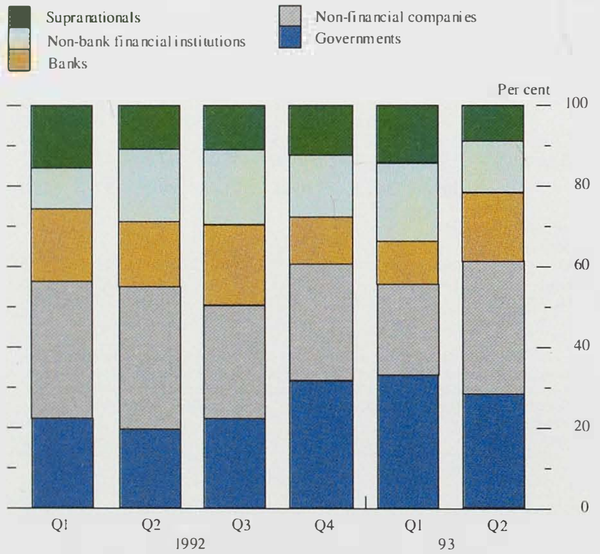


Source: Bank of England ICMS database and BIS.

Government borrowing still strong

The high level of borrowing by governments and other public sector entities has been a notable feature of recent quarters, as shown by Chart 2. Canadian provinces and European governments have been prominent borrowers. As in the previous quarter, the Scandinavian countries and Italy were among the largest sovereign borrowers in the second quarter. In May, Italy, which has so far achieved $7.2 billion of the $10–15 billion borrowing programme announced at the start of 1993, offered investors the opportunity to exchange their holdings of existing US dollar bonds for two new floating-rate notes (FRNs). The globalisation of public debt management—as governments seek to gain access to deeper and more liquid pools of funds than are available domestically—has been a recent phenomenon. One corollary is the development of liquid benchmark issues which attract wider investor interest and boost secondary market trading (see below).

Chart 2
Borrowers in the international bond market



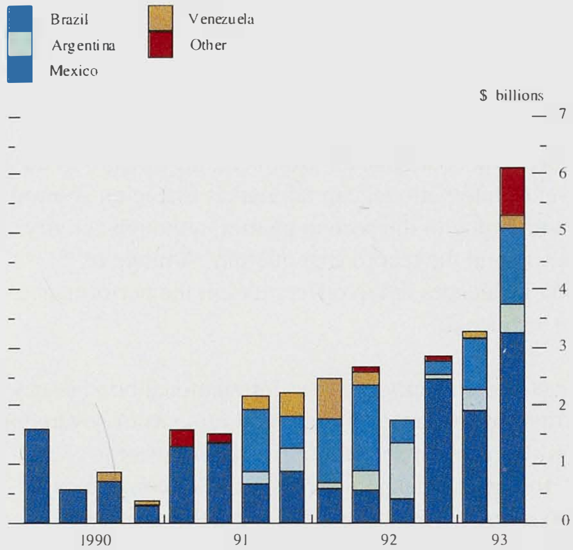
Source: Bank of England ICMS database.

The share of borrowing by non-financial companies increased from one quarter to one third in the second quarter, despite unfavourable economic conditions in a number of major countries—which reduced the demand for new finance and affected perceived creditworthiness—and the opportunities for fund-raising in domestic markets and the rapidly growing euromedium-term note (EMTN) market. As a result of these alternative opportunities for fund-raising, the large volume of maturing equity warrant bonds launched by Japanese companies in the late 1980s is being refinanced across a wide range of market segments.

Latin American issues at record levels

Private sector entities from the developing world significantly strengthened their presence in the international bond markets. They accounted for three quarters of a record level of international bond issues by Latin American borrowers ($6.1 billion) in the second quarter, which was nearly twice the first quarter level and the highest since their return to the international capital markets in 1989–90 (Chart 3). Mexican companies again accounted for over one half of the Latin American private sector issues, but Brazilian companies also increased their borrowing. The range of Latin American private sector borrowers tapping the international bond markets widened to include entities from several other countries, such as Chile and Uruguay.

Chart 3
Latin American international bond issues



Source: Bank of England ICMS database.

To curb the sharp increase in issues by Brazilian banks to take advantage of interest rate differentials, the Brazilian authorities introduced measures in June to lengthen the minimum maturity of issues and the qualifying original maturity for exemption from withholding tax. Investors have been increasingly attracted to Latin American bonds by the favourable yields they offer relative to issues by many borrowers in the OECD area, and by a perception among many institutional investors that the creditworthiness of many Latin American companies is improving, aided in the case of Mexico by optimism over NAFTA.

US dollar issues strong

Although issues in the dollar sector fell in the second quarter, this followed an exceptional first quarter level. The US dollar share of total international bond issues rose to 33% in the second quarter, as shown in Table B. The market

Table B
Currency composition of fixed-rate bond issues(a)

Percentage of total issues announced

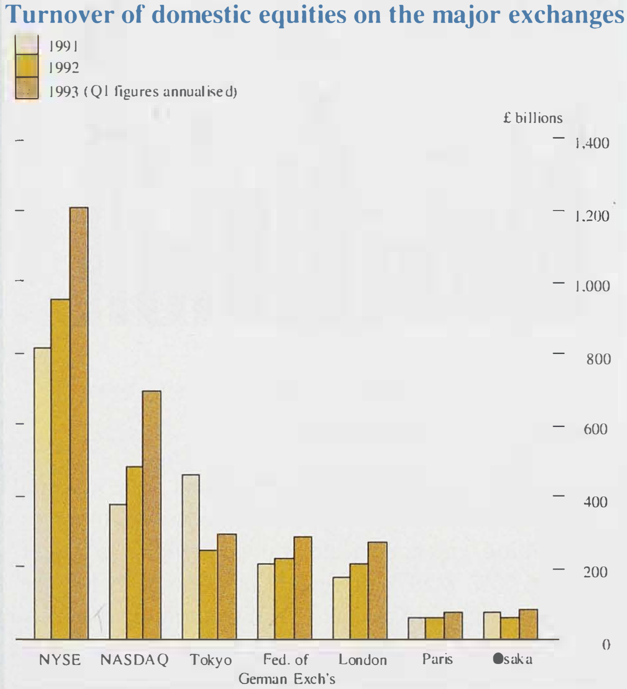
	1991	1992		1993	
Currency denomination	Year	Year	Q4	Q1	Q2
US dollar	29	33	31	30	33
Ecu	12	7	—	5	2
Deutschmark	4	11	18	16	7
Swiss franc	5	5	8	3	5
Sterling	7	7	8	9	10
Canadian dollar	10	6	1	11	5
Yen	15	14	17	13	9
French franc	7	9	10	7	15
Italian lira	3	2	—	1	5
Other	8	6	7	5	9
Total	**100**	**100**	**100**	**100**	**100**

(a) Excluding equity-related issues.

London's share of global equity turnover

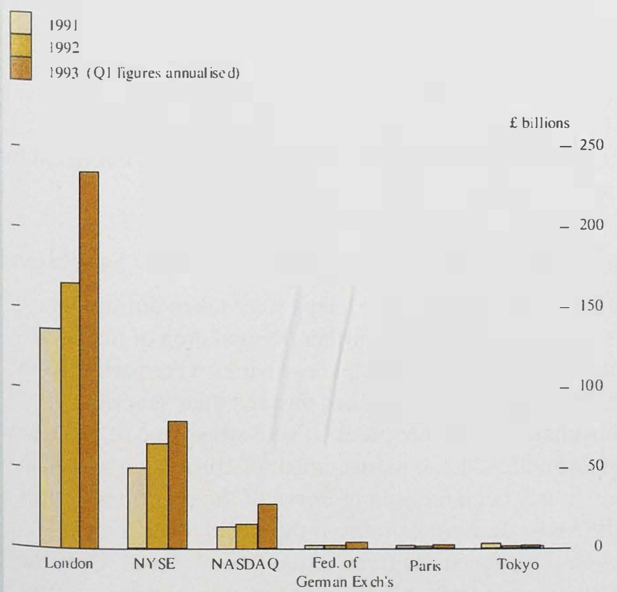
Secondary equity market turnover can be divided into trading of domestic equities (shares of companies incorporated in the home country) and trading of overseas equities (shares of foreign-incorporated companies).

Chart A
Turnover of domestic equities on the major exchanges



Domestic equity turnover on the major international equity markets (defined as markets with a capitalisation of over £200 billion) totalled nearly £2,300 billion in 1992, of which London accounted for 9.5%. Turnover of overseas equities on these markets totalled over £250 billion, of which London's share was 65%. Charts A and B show the total amounts of domestic and overseas turnover on the major international equity markets between 1991 and 1993.

Chart B
Turnover of overseas equities on the major exchanges



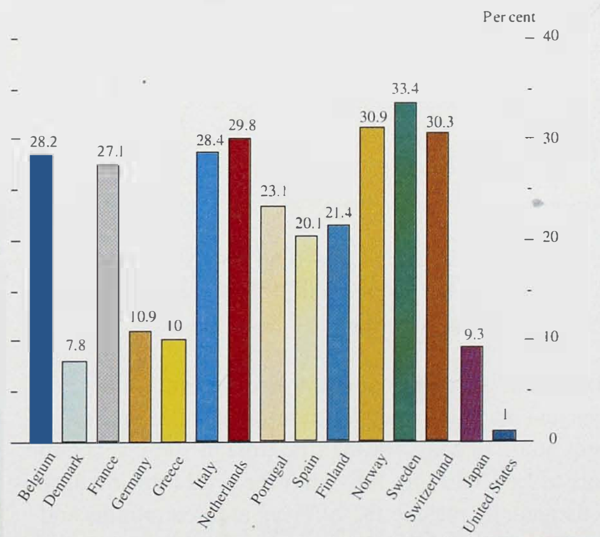
The market for overseas equities in London

The London Stock Exchange's SEAQ International (SEAQI) trading system provides the platform for the world's largest market for overseas equities. SEAQI's quote-driven structure and relatively light regulatory regime appears to provide institutional investors with superior liquidity for wholesale trades. At the end of March 1993, 587 overseas securities were quoted on SEAQI (of which 415 were firm quotes and the remainder were indicative).

Although SEAQI allows for trading in the securities of countries from all over the world, in practice trading on SEAQI is concentrated mainly in European and Japanese equities. In 1992, trading in French, German and Japanese equities each accounted for around 15%–20% of total turnover of overseas equities in London, with European equities as a whole making up 65% of the total.

Another way to measure the size of the London market in overseas equities is to express turnover in London as a percentage of total turnover around the world in the equities of companies incorporated in a particular country. Chart C shows that London accounts for a sizable proportion of the total market for equities from a wide range of countries.

Chart C
Turnover of overseas equities in London in 1992, as a percentage of global turnover in those equities



Footnote: measurement of turnover

Different stock exchanges measure turnover in different ways. As far as possible, measures of turnover in this box have been reduced to single-counted figures (ie the sum of total sales or total purchases). However, problems remain in comparing turnover in dealership markets (where intermediaries trade as principals) with turnover on order-driven markets (where intermediaries act as agents between end-investors). Turnover may also be inflated through double counting where trading takes place on a network of exchanges rather than on a single exchange; and there are differences between those exchanges which measure business transacted through their trading system and those which measure business transacted by their member firms. As a result, considerable caution must be exercised in comparing figures for turnover on different stock exchanges.

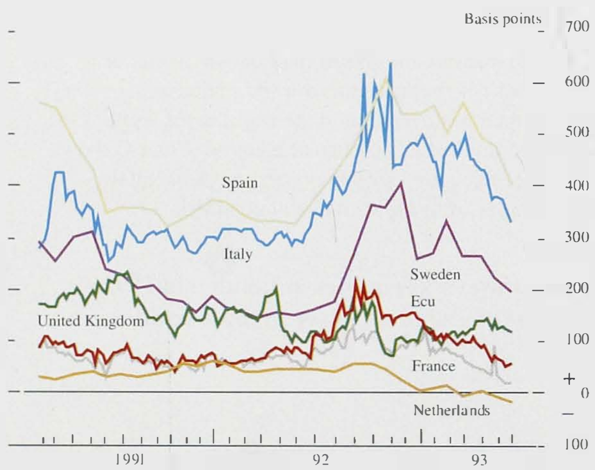
In order to achieve the maximum degree of consistency, a common numeraire currency is needed. Because of the devaluation of sterling in September 1992, constant 1991 exchange rates have been used as a base against which to compare equity turnover on the major stock exchanges during 1992 and 1993 Q1.

absorbed a large flow of sovereign, supranational and corporate paper as borrowers took advantage of low interest rates to lock into lower funding costs, and investor sentiment was bullish on expectations of an appreciation of the US dollar against European currencies.

Increased activity in many European currency sectors

Activity revived during the second quarter in some European currency sectors of the international bond market as yields fell back to more normal levels relative to DM yields after last year's foreign exchange market turbulence (see Chart 4). The popularity of high-yielding currencies revived (the lira's share of total issues rose to 5%) and the French franc became the second largest currency of issuance. Issues

Chart 4
Government bond yield differentials (a)



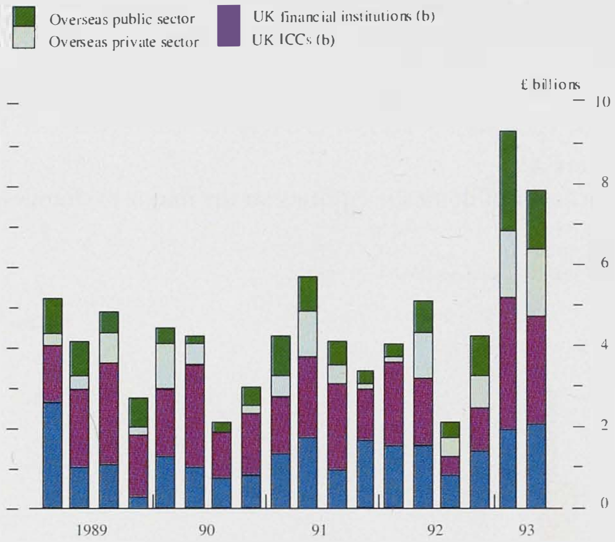
Source: Bloomberg and Datastream.
Note: Weekly data except for the Netherlands, Spain and Sweden.
(a) Ten-year government bond yield over German bonds.

in Ecu remained subdued (2% of total issues), although above the levels in the second half of last year, and were mainly by government entities.

The Bank held its regular monthly Ecu Treasury bill auctions and also held a tender to re-open the 1996 Ecu Treasury note. In May, for the first time in some years, the amounts of Ecu Treasury bills on offer at all three maturities were changed, increasing the offering at three months and reducing the tenders at one and six months. This change was made in response to the demand shown at recent auctions. Of the 1,000 bills on offer in May, 930 were allotted to market-makers at acceptable yields. In June and July, the tenders were oversubscribed at all three maturities at levels up to 15 basis points below Libid. Monthly turnover in the bill market increased from around ECU 1.5–2 billion in March and April to over ECU 3 billion in June and July.

Following the first tender in early February 1993 for HMG's Ecu Treasury note maturing in January 1996 (the second three-year note in the series), the note was re-opened, as scheduled, on 20 April with a tender for ECU 500 million. The fine terms and level of oversubscription at these two tenders reflected the benchmark status of this debt in the Ecu

Chart 5
Sterling debt issues announced: (a) **by type of issuer**



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

market. A further ECU 500 million of this issue was sold by tender as scheduled on 20 July. Total bids were over ECU 2 billion, and notes were allotted at yields in a tight range of 6.56%–6.59%, around 15 basis points below the theoretical composite basket. Average monthly turnover in the new note has been more than ECU 2 billion during the quarter.

Announcements of new sterling issues remained high in the second quarter, but below the exceptional levels of the previous quarter (see Chart 5). Issues were heavily concentrated around a maturity of five years, where issuers were able to exploit swap opportunities. Several ten-year issues were announced towards the end of the quarter as long yields fell to historically low levels.

Several of the sterling issues announced during the quarter were large, demonstrating the generally increased depth of the sterling market. Abbey National and GEFCO both brought £500 million deals with a five-year maturity. The EIB issued a further £400 million tranche of ten-year stock, which increased the total size of its issue to £1 billion, making it the largest euro-sterling issue in the market at that time.

Bond market regulations eased in Japan and Switzerland

In Japan and Switzerland, steps were taken during the second quarter towards further deregulation of the bond markets. From 1 April Japanese banks were permitted to lead manage euro-yen issues through their securities subsidiaries and were quick to take advantage of these new opportunities. Lead management of euro-yen issues had previously been the sole preserve of the securities houses. The Swiss authorities relaxed their lead management regulations for Swiss franc issues from 1 April. Only the lead manager (rather than, as before, all members of the syndicate) is now required to be domiciled in Switzerland or

UK equities settlement: the Task Force Report

UK equities settlement: the Task Force Report

The Task Force on Securities Settlement reported to the Governor at the end of June, in line with its terms of reference. Its recommendations on how to take forward settlement and equity transfer in the United Kingdom were published on 1 July. Copies of its report are available free of charge from the Bank. The Task Force was set up on 11 March 1993 by the Governor at the request of the Chairman of the Stock Exchange, after the Exchange's decision to suspend work on the TAURUS project. It was chaired by Pen Kent, an Associate Director of the Bank.

The Task Force recommendations

The Task Force has recommended a phased approach to improving equity settlement, rather than the 'Big Bang' strategy planned for TAURUS. Initially, enhancements to Talisman, the current UK system, will be considered. Currently, trading takes place within two-week account periods and all trades from a particular account period are settled on the second Monday after the end of the account period.

The changes to be considered will include moving within the Talisman environment to rolling settlement, under which each day's trades are settled on a separate day, a fixed number of days after trading takes place (T+n). The Task Force recommends a move to ten-day (T+10) rolling settlement for the whole market by mid-1994, and then T+5 rolling settlement as a market norm from the beginning of 1995.

The Task Force envisages the subsequent introduction of a new settlement system ('CREST'), which will go live in 1996. The Task Force report gives an outline design brief for CREST. The Bank has agreed to take forward the validation and detailed specification work within this brief over the next six to nine months. This will include intensive consultations with the market. A steering committee, chaired by Pen Kent and comprising representatives from the securities industry, has now been assembled and will oversee this process. The question remains open of who will build and own the system.

The CREST system

At present, the transfer of stock ownership requires the movement of paper (share certificates and transfer forms). CREST, an electronic book entry transfer system, will eliminate much of this paper movement. This will eventually enable the rolling settlement standard to be shortened to T+3 or perhaps even further.

Membership of CREST will be open to anyone able to meet the specified criteria, which are likely to include capital requirements, technical competence and professional standing. Each member will have one or more stock holding accounts and the name of each account will be shown individually on company registers. This 'name on register' facility is different from central nominee models such as SEPON in the existing Talisman system. In these models, only the name of the central nominee appears on the company register, making it more difficult for companies to identify the underlying owners of their stock.

Individual investors are unlikely to become CREST members themselves. They will have the choice of keeping their certificates if they wish, so that their names stay on company registers. The introduction of CREST need not entail any cost for those holding stock in this form. This option would not have been available under TAURUS, which required companies to dematerialise all their stock if they wished to have any of it settled in the system. Alternatively, investors may choose to hold their stock in nominee accounts of members of CREST. This would mean that the individual would no longer have a physical certificate, but would be able to take advantage of the lower transaction costs of the paperless transfer offered by CREST.

Corporate events such as dividends, scrip issues and rights issues will also be handled by CREST. High performance standards will be set for registrars of stocks transferred in CREST, and this will help to reduce the need for processing such events within CREST itself.

Payment arrangements for CREST

When trades are settled, there is a risk that an individual's counterparty may default after receiving stock but before making payment (or may fail to deliver stock against a payment received). This risk, which is known as principal risk, can lose the individual the entire value of the transaction.

Under the current netted settlement method employed by Talisman, the principal risk is transferred from the individual to the central guarantor. Once all the stock has been moved, each participant pays or receives a single amount to or from a central counterparty (the Stock Exchange) to cover all his transactions for that day.

CREST will remove principal risk from the system altogether by introducing the use of 'delivery versus payment' (DVP), under which transfers of stock and payment are made simultaneously on a deal-by-deal basis. Funds injected into the system will circulate within it as deals are settled; members will not need to fund each deal separately. The DVP arrangements will be based on existing banking relationships. CREST will only allow direct members of CHAPS (Clearing House Automated Payments System, the UK interbank payment system) to maintain an account on behalf of CREST participants at its own bank, which could be the Bank of England. These accounts will be funded through the day by CHAPS messages (ie guarantees by settlement banks to make good payment at the end of the day). In turn, it will be up to each settlement bank to agree with each participant how funds are made available: the bank may offer credit or require cleared funds to be in the client's account.

It is planned that CHAPS will move from an end of day net settlement system to a real time gross settlement system in 1995. Once this is available, CREST will be able to achieve full DVP, as stock will be able to move within the day against individual payments.

Liechtenstein. The Swiss authorities also removed stamp duty from securities transactions in foreign bonds with a view to increasing the competitiveness of the Swiss market.

High secondary market turnover in fixed-rate bonds

Secondary market trading of fixed-rate bonds was stronger than in the first quarter, totalling a record $4,100 billion. Trading in fixed-rate deutschmark bonds continued to grow, accounting for over one third of the fixed-rate bonds traded during the second quarter, compared with one fifth the equivalent quarter in 1992. The DM five-year and US$ ten-year bonds issued under HMG's foreign currency borrowing programme continued to be among the most actively traded.

Continuing revival in FRNs

The value of FRN issues remained high during the second quarter at nearly $14 billion, as shown in Chart 6. Several factors lie behind the revival of the FRN market:

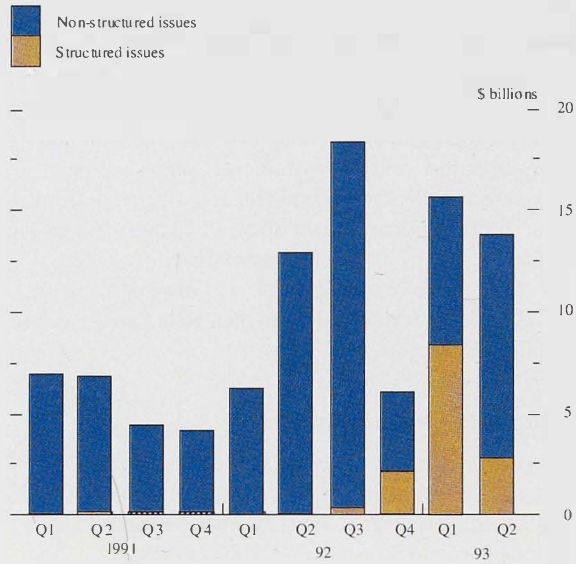
- banks and other financial institutions have faced pressing capital needs;
- expectations that US short-term interest rates may rise from their present low levels stimulated investors' interest in US$-denominated FRNs, which accounted for 80% of total issues (up from 55% in the previous quarter);
- in the second quarter, government borrowers (notably Sweden and Italy) were prominent, accounting for over 25% of total FRN issues;
- structured FRNs (such as 'collared' issues which guarantee minimum and maximum returns) continued to be favoured, although their value fell to around one fifth ($2.8 billion) of total FRN issues in the second quarter after the exceptional first quarter level; and
- declining swap margins have increased the attractiveness of FRN issuance over fixed-rate issues which are then swapped.

Equity-related bond issues still subdued

With only limited issues of equity-related bonds in the second quarter ($8.3 billion) and a high level of redemptions of equity-related bonds by Japanese companies, the value outstanding fell further. (Some $80 billion of Japanese equity-related bonds are due to expire during 1993.) The weakness of the Japanese equity market has deterred investors from exercising their conversion options and has prompted issuers to explore other means of refinancing.

However, issues in the sterling convertible bond market continued to be relatively buoyant in the light of the resilience of the UK equity market and generally positive sentiment towards sterling. Twenty-four convertible bond or preference share issues have been made since last September, when sterling's membership of the ERM was suspended.

Chart 6
Floating-rate note issues

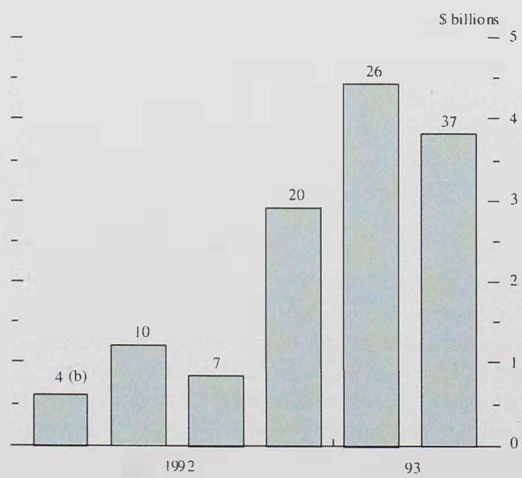


Source: Bank of England ICMS database.
Note: Structured issues pay minimum and maximum coupons, for example, or might be negatively linked to interest rates.

Continued strong growth in the EMTN market

The EMTN market's attractiveness to issuers as an alternative to the conventional eurobond market has been enhanced by the wider range of options and techniques that has become available (such as underwritten EMTNs). Although only 11 new programmes, totalling $9 billion, were arranged during the second quarter, the value of outstanding issues rose a further $17 billion in the second quarter to $95 billion, more than the rise in the first quarter. Most of the issues were made under existing programmes. The number of underwritten EMTN issues rose to 37 in the second quarter from 26 in the first quarter (Chart 7). Regulatory changes increased the range of currencies which can be included as options under EMTN programmes to include Swiss francs and French francs. Japan reduced the authorisation period for EMTN issues from fourteen to three days.

Chart 7
Underwritten EMTN issues (a)



Source: Bank of England ICMS database.

(a) Euromedium-term note issues underwritten by a syndicate of investment banks.
(b) Number of issues.

ECP market still quiet

Activity in the eurocommercial paper (ECP) market remained subdued: the outstanding level rose by $1 billion in the second quarter to $76 billion, but is almost $10 billion less than a year ago. Low dollar interest rates, which encouraged investors to switch into longer-term paper (such as EMTNs), and growing competition from domestic commercial paper markets (including recently deregulated European markets) have dampened the development of the ECP market.

Sterling commercial paper (SCP) outstandings have shown an overall rise so far during 1993, as rates at which companies are able to issue have become more attractive relative to bill rates. SCP outstandings were £3.8 billion at the start of 1993 and reached a peak of £5.5 billion at the end of May.

Selective approach in syndicated credit market

The negative influences on syndicated credit activity remained strong during the second quarter. The weakness of the world economy, subdued merger and acquisition activity and the availability of alternative financing channels all tended to reduce demand for new facilities; and banks continued to be cautious and selective about new lending, which was also reflected in a tightening of lending terms (such as wider spreads). The rise in announced syndicated credit facilities by over one half to $64 billion during the second quarter therefore reflected special factors. Most important was borrowing by US companies, largely to refinance existing facilities. Asian borrowers (eg from Indonesia and South Korea) were also again active, although their share of the total market remains small; and some Middle Eastern borrowers (from the Lebanon and Syria) announced facilities for the first time in several years.

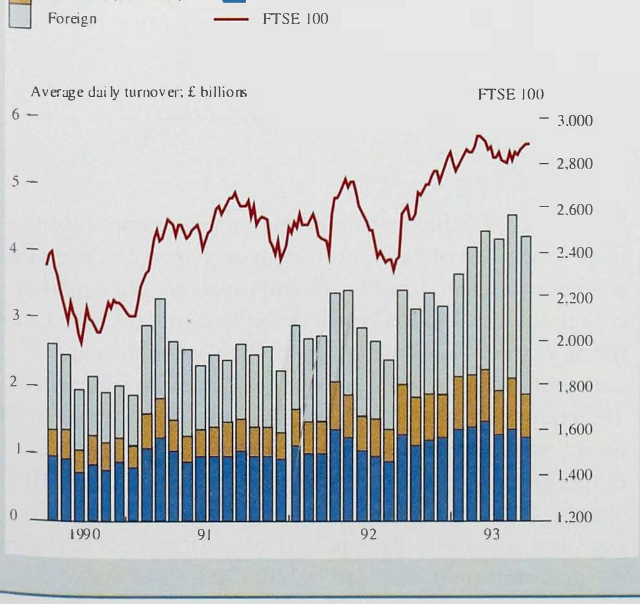
London Stock Exchange: second quarter 1993

Equity prices, issues and turnover

The FTSE 100 traded for most of the second quarter in a narrow range of 2,800–2,900, as shown in the chart, reaching a high of 2,908 on 22 June. The FTSE 250 and Small Cap indices rose by 4% and 6% respectively over the quarter.

New equity issues announced in the second quarter remained high, with a total value of some £4.5 billion. A large number of new issues tend to be brought around the spring reporting season, but new issues this year also appear to have been encouraged by improved prospects for recovery. New equity raised during 1993 to date has already exceeded the total for the whole of 1992. Rights issues continued to be the preferred method of issue, after a quieter year in 1992, and raised £7.4 billion in the first half of 1993. Almost £1 billion of this was raised by property companies, which took advantage of signs of stabilisation in the property and housing markets and rising share prices to make new acquisitions and reduce gearing.

Equity turnover and prices on the London Stock Exchange



Secondary market turnover maintained the high values seen in the first quarter, with daily turnover in UK stocks averaging £2 billion, of which customer business represented £1.2 billion. Average spreads narrowed across all categories of stocks, reaching their lowest levels since 1991. Daily turnover of overseas stocks by member firms exceeded that of UK stocks for the first time since data became available in 1989, averaging £2.2 billion in the second quarter.

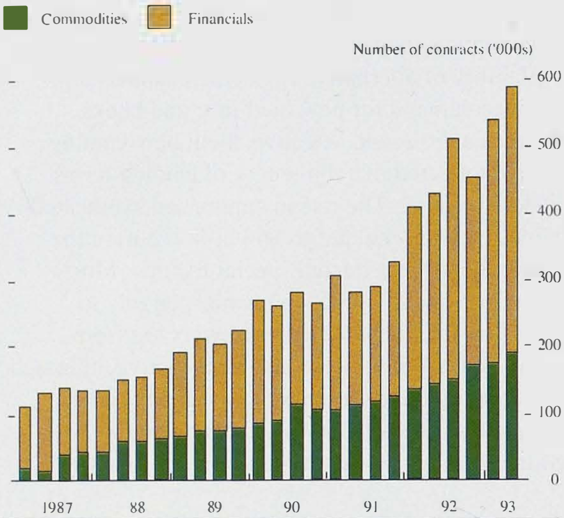
Gilts turnover

Average daily turnover in the gilt-edged market (including intramarket business) was £5.6 billion in the second quarter, compared with £6.3 billion in the first quarter. The average number of bargains fell from 3,614 in the first quarter to 2,846.

New trading system for the Stock Exchange

The Stock Exchange announced on 3 June that it would replace SEAQ with a new trading system, SEQUENCE, developed by the Exchange in co-operation with Andersen Consulting. The new trading system, which demonstrates the Exchange's commitment to quote-driven markets for the majority of stocks (while maintaining an order-driven capacity for the most illiquid stocks), will be phased in over the next two and a half years. The Exchange will now consult with its users over the system's scope, functional specifications and delivery schedule.

Chart 8
Turnover on the London derivatives exchanges



Derivatives markets activity buoyant

Derivatives markets remained active in the second quarter. Trading volume on the four principal London derivative exchanges, LIFFE, LME, IPE and LCE (formerly FOX), reached new records (Chart 8). Volume on LIFFE and LME, which grew particularly strongly, benefited respectively from uncertainty over European interest rates and volatile copper and aluminium prices.

Data on over-the-counter (OTC) business are limited, and not available on a timely basis. However, it is thought that the OTC market was stimulated by borrowers and investors seeking to benefit from falling interest rates and changes in the shape of the yield curves. Many fixed-income bonds continued to be swapped into floating-rate commitments as borrowers sought to reduce their costs of funding.

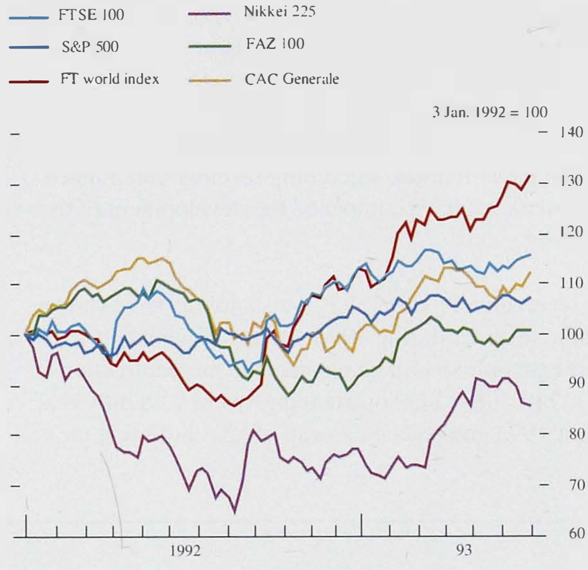
Little change in equity prices

There was limited movement in most major stock market indices during the second quarter of 1993, as shown in Chart 9. The US equity markets were little changed as expectations of growth faded and concerns over inflation rose. In Japan, the Nikkei ended the quarter some 5% higher, with its rise early in the quarter (reflecting increased investment by state pension funds and high interest from overseas investors owing to appreciation of the yen) more than offsetting a fall following the no-confidence vote in the Government on 18 June. The UK stock market rose modestly amid receding expectations of a further interest rate cut in the near term. Equity prices in some major continental European markets increased slightly, encouraged by cuts in German interest rates. However, the Italian equity market rose by 13% and the Danish market rose strongly ahead of the result of the second Maastricht referendum.

Banks' performance generally depressed—US banks an exception

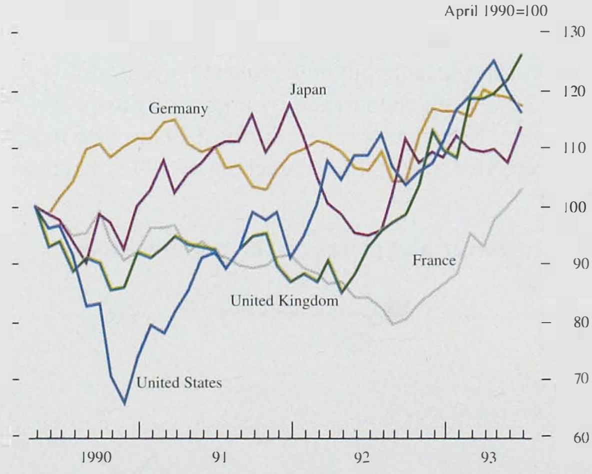
Bank profitability in several countries continues to be depressed by cyclical economic weakness and asset-quality problems which have led to high levels of provisions. For example, the major 21 Japanese banks reported falls in pre-tax profits, reflecting the weakness of the economy, provisioning and losses on securities holdings. French banks have been affected by property-related loan losses; and large banks in countries such as Germany and Spain are starting to be affected by asset-quality concerns.

Chart 9
Equity indices(a)



(a) End-week prices.

Chart 10
Banks' share prices relative to local equity markets



Source: Datastream.

By contrast, US banks continued to report record profits, largely because of buoyant foreign exchange and securities trading revenues. In addition, improved property market conditions enabled US banks in the first quarter to reduce the amount of foreclosed property held on their books compared with the previous quarter—the first time since 1979 that they have been able to do this. In response to the banks' strong performance, US bank share prices have outperformed overall equity market indices, as Chart 10 shows. In several other countries bank share prices have been low relative to the equity market as a whole, reflecting the pressures on banks' profitability described above.