Financial market developments

Overview

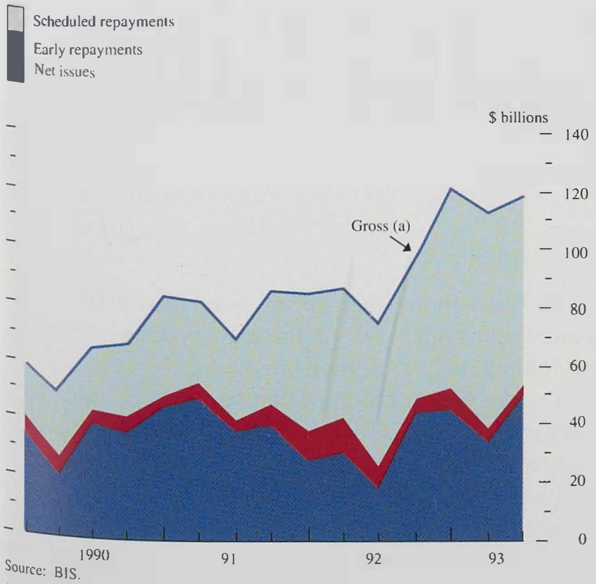
International financing activity was high in the first three quarters of 1993, with international bond issues exceeding the total raised during the whole of 1992. Much of this was refinancing of maturing debt; sovereign borrowers also tapped the market to replenish foreign exchange reserves or to finance widening fiscal deficits. Many issues were at longer maturities than has been usual in the euromarkets, as borrowers took advantage of historically low yields and investors looked to longer maturities for higher yields. Globally issued bonds were increasingly popular.

Turbulence within the European exchange rate mechanism (ERM) and expectations of cuts in European interest rates had a significant impact on activity in European securities and derivatives markets. New eurobond issues in ERM currencies were low in July, but Deutsche Mark issues increased sharply in the following two months, largely at the expense of the French franc. New sterling debt issues in the first three quarters of 1993 exceeded the previous annual record set in 1991.

Equity prices rose in all the major markets during the third quarter, in response to expectations of interest rate cuts in some countries and economic recovery in others. With the UK market rising to new heights during August, new equity issues in the year to date exceeded annual totals for all years except 1987.

Activity in the syndicated credit market remained fairly flat, with the number of announcements slightly below those in the same period of 1992. A number of factors contributed: demand for bank finance was dampened by the uncertain prospects for the world economy; the buoyant capital markets offered widespread alternative funding opportunities; and banks continued to take a cautious and selective approach to new lending (though there are signs that spreads narrowed slightly for highly rated borrowers).

Chart 1
International bond issues



Source: BIS.

(a) Gross issuance is measured at date of completion rather than announcement, and may therefore differ from the figures given in Table A.

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

$ billions; by announcement date

	1991 Year	1992 Year	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993 Q3
International bond issues							
Straights	263.1	281.5	51.6	73.6	122.8	88.1	82.2
Equity-related	43.8	24.0	4.8	8.8	8.6	8.3	10.6
of which:							
Warrants	*31.8*	*18.3*	*4.4*	*6.3*	*6.2*	*3.7*	*5.5*
Convertibles	*12.0*	*5.7*	*0.4*	*2.5*	*2.4*	*4.6*	*5.1*
Floating-rate notes	21.8	43.2	18.2	6.2	15.6	13.6	19.0
Bonds with non-equity warrants (currency, gold, debt)	1.0	1.2	0.2	0.2	0.8	0.4	0.2
Total	**329.7**	**349.9**	**74.8**	**88.8**	**147.8**	**110.4**	**112.0**
Credit facilities							
Euronote facilities	95.9	113.2	29.8	37.9	15.2	13.4	31.1
of which:							
CP	*38.3*	*21.5*	*3.0*	*11.6*	*5.7*	*3.4*	*2.9*
MTNs	*56.0*	*90.8*	*26.6*	*26.3*	*9.5*	*9.7*	*27.9*
NIFs/RUFs	*1.6*	*0.9*	*0.2*	*0.1*	—	*0.3*	*0.3*
Syndicated credits	136.7	221.7	65.2	47.1	42.5	69.4	52.1
Total	**232.6**	**334.9**	**95.0**	**85.0**	**57.7**	**82.8**	**83.2**
Memo: amounts outstanding							
All international							
Bonds(b)	1,648.3	1,686.4	1,767.0	1,686.4	1,741.8	1,777.8	1,843.6
Euronotes(c)	144.9	173.1	174.9	173.1	182.6	199.3	234.6
of which, EMTNs	*38.5*	*61.4*	*53.7*	*61.4*	*77.8*	*94.8*	*124.6*

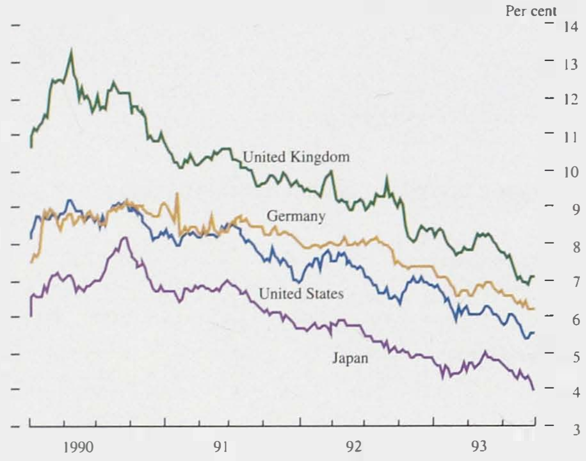
(a) Maturities of one year and over. The table includes euro and foreign issues and publicised placements. Issues which repackage existing bond issues are not included. Figures may not add to totals because of rounding. Bond total includes issues from MTN programmes.
(b) BIS adjusted figures, including currency adjustment. Includes issues of fixed-rate bonds and floating-rate notes.
(c) Euroclear figures.

International bond markets

Large-scale borrowing in the international bond markets continued in the third quarter of 1993, as Table A shows. The value of issues in the third quarter was some 50% higher than a year earlier and, despite seasonal weakness, exceeded issues in the second quarter. Borrowers' needs to refinance maturing debt remained a prominent factor, with some $250 billion of bonds due to mature in 1993. Consequently, after redemptions and early repayments, growth of net bond issuance was much more muted than gross issuance, and amounted to only $50 billion (see Chart 1).

With low and falling long-term government bond yields in many currency sectors (see Chart 2), investors moved towards longer maturities in search of higher yields (often to replace maturing high-coupon debt). Many borrowers were consequently able to issue much longer-term debt than has

Chart 2
G3 and UK ten-year government bond yields



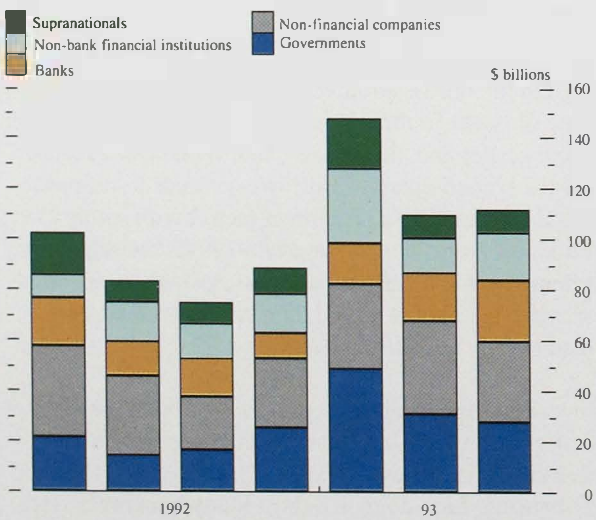
Source: Bloomberg.

traditionally been common in the euromarkets, while still locking into historically low yields: in the third quarter almost one sixth of eurobond issues were for maturities beyond ten years.

The increasing popularity of global issues continued in the third quarter, when they accounted for one tenth of all issues and almost one third of national and regional governments' borrowing. First issued by the World Bank in 1989, global bonds are issued simultaneously in the European, US and Far East markets, and can be traded through both domestic and international clearing systems. Italy, which has a $10–15 billion overseas borrowing programme for 1993, launched the largest ever global bond with a $3½ billion 30-year issue in September (part of a larger $5½ billion package).

National and regional governments, which have been prominent borrowers in the international bond markets in recent quarters, maintained their overall level of borrowing in the third quarter (see Chart 3). Certain national governments, in particular Denmark, borrowed heavily to replenish their foreign exchange reserves in the wake of the pressures on the ERM, and Canadian provinces continued to be large borrowers in order to finance high budget deficits.

Chart 3
Borrowers in the international bond market

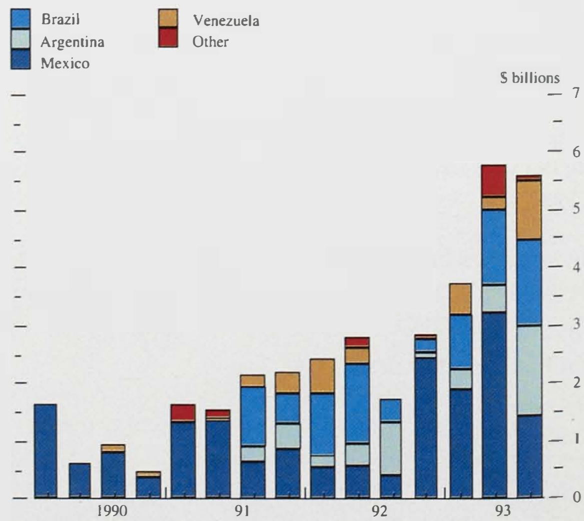


Source: Bank of England ICMS database.

Non-financial companies accounted for one quarter of international bond issues in the first three quarters of 1993. Nevertheless, they were net repayers of principal; $13.2 billion up to end-September. By contrast, governments and non-bank financial institutions accounted for the majority of the net amount issued, $68.8 billion and $34.5 billion respectively, over the same period.

Issues by Latin American borrowers (see also box on page 471) in the international bond markets fell from the second quarter's peak (see Chart 4), but were still three times the level of a year earlier. Private sector entities continued to account for over half of the total, benefiting from perceptions of improving creditworthiness and investors' demands for yields above those available from OECD borrowers (on average, the yield pick-up was over 200 basis points in the US dollar sector). Issues by Mexican entities, however, fell sharply compared with the second quarter, in view of investors' reluctance to accept narrower spreads on Mexican bond issues.

Chart 4
Latin American international bond issues



Source: Bank of England ICMS database.

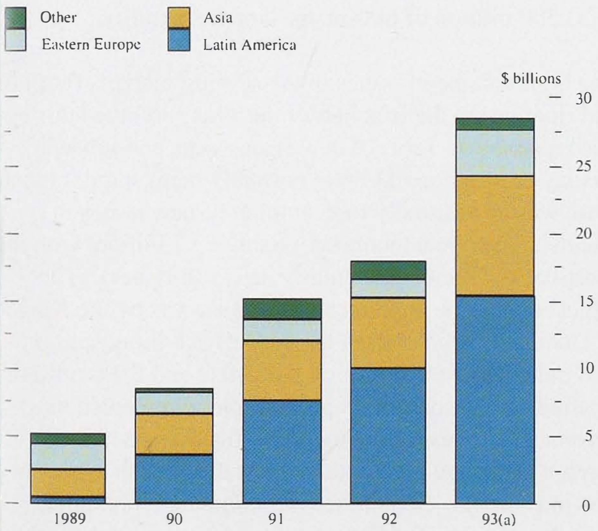
Currency sectors

US dollar issues in the international bond market fell in the third quarter, though the US dollar remained the most popular currency for fixed-rate international bonds, accounting for almost one third of all issues (see Table B). The yield on 10-year Treasury bonds fell during the period, touching a low of 5½% in September (see Chart 2). Although the high level of US dollar-denominated bonds maturing in the third quarter stimulated refinancing activity, low yields and the decline in the dollar exchange rate against the yen reduced international demand for dollar-denominated assets.

Non-OECD borrowing in the international bond markets

Non-OECD borrowers regained access to the international bond markets in 1989. Since then they have made increasing use of these markets (see the chart)—in the third quarter of 1993, $10 billion was raised by non-OECD borrowers, more than double the amount raised in the same quarter of the previous year (see the table). This rise reflects the return of investor confidence in Latin America and the increasing attraction of investment in Asian economies. Eastern European borrowers have also begun to tap the international bond markets, although on a smaller scale (the Hungarian and Czech central banks have been the only issuers from the region so far).

International bond issues by non-OECD borrowers



Source: Bank of England ICMS database.

(a) Data to 1993 Q3.

An important factor behind the increase in non-OECD borrowing has been the low interest rate environment in the United States and Japan over the past few years. This has led investors to search for higher yields than are available on eurobonds from high-quality borrowers from the OECD area. Latin American borrowers, as well as those from other emerging regions, particularly Asia, have taken advantage of this.

Several factors have contributed to the steady increase in non-OECD borrowing in recent years, in particular the confidence induced in foreign investors by the adoption of stability-oriented policies and the completion of debt restructurings. Latin American issues have not been confined to bonds, and issuers have diversified their range of borrowing instruments and the markets from which they borrow. Mexican, Brazilian and Argentinian borrowers have, for instance, issued euromedium-term notes and eurocommercial paper. Mexico has also issued sovereign debt in the US foreign bond market, and some Mexican borrowers have issued US domestic commercial paper.

Mexican entities have been the most active Latin American borrowers in the international bond markets (see Chart 4 in the main text), having issued $7 billion in 1993 to date compared with $4 billion in the whole of 1992. Investor perception of Mexican borrowers over the coming months could receive a further boost if the North American Free Trade Agreement is ratified. Brazilian private sector banks have also been prominent. High domestic interest rates in Brazil have allowed the banks to offer attractive yields to international investors while on-lending the proceeds domestically at wide profit margins.

The cost to Latin American entities of borrowing in the international markets varies between countries, reflecting their perceived creditworthiness. Most Latin American borrowers have seen spreads narrow since their return to the market; they have narrowed most for Mexican entities. In line with improved creditworthiness, the maturity structure of Latin American borrowing has lengthened. In 1991, maturities were generally up to three years, though the average maturity has now risen to five years and some Mexican borrowers have issued at a maturity of twelve years.

Asian borrowers have also been making increasing use of the international bond markets. The proportion of non-OECD international bonds issued by Asian borrowers has risen from one quarter in 1992 to almost one third in 1993, with Korea, Taiwan and Thailand accounting for most of the borrowing. Euroconvertible bonds have been popular instruments with international investors, since they offer the opportunity to obtain exposure to equity markets which might otherwise be restricted by shareholding limits placed on foreign investment. In the past year there have been several deregulatory initiatives and a loosening of restraints on offshore financing to encourage borrowers to tap the international capital markets, while high domestic interest rates provided an additional incentive.

Borrowing by non-OECD entities in the international bond markets

$ billions at a quarterly rate

	1991	1992			1993		
	Year	Year	Q3	Q4	Q1	Q2	Q3
International bond issues(a)							
Straight fixed-rate	2.9	3.5	2.4	3.7	6.6	8.0	8.9
Equity-related	0.5	0.4	0.2	0.9	0.6	0.8	0.8
FRNs	0.4	0.6	1.0	0.8	0.7	1.6	0.5
Total	**3.8**	**4.5**	**3.6**	**5.4**	**7.9**	**10.4**	**10.2**
of which:							
Latin America	*1.8*	*2.5*	*1.7*	*3.2*	*3.8*	*5.8*	*5.5*
Asia	*1.1*	*1.2*	*1.5*	*1.3*	*2.3*	*3.7*	*2.7*
Eastern Europe	*0.3*	*0.3*	*0.2*	*0.6*	*1.6*	*0.2*	*1.5*

Source: Bank of England ICMS database.

(a) Excluding bonds issued as a result of debt rescheduling agreements.

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

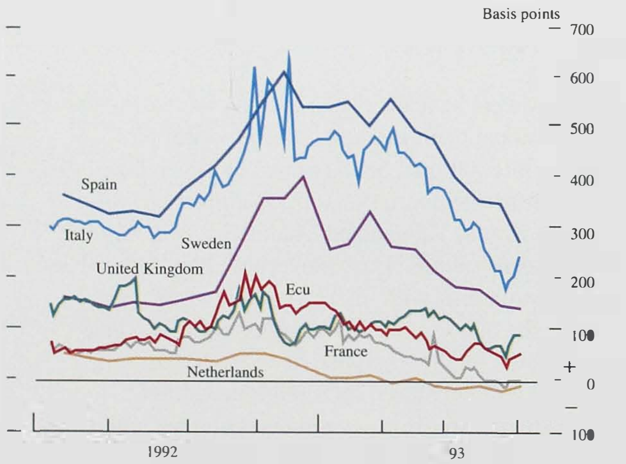
Percentage of total issues announced

Currency denomination	1991 Year	1992 Year	1993 Q1	Q2	Q3
US dollar	29	32	30	33	29
Ecu	12	7	5	2	2
Deutsche Mark	5	11	16	7	13
Swiss franc	5	5	3	5	6
Sterling	7	6	9	10	8
Canadian dollar	10	6	11	5	8
Yen	15	14	13	9	16
French franc	6	8	7	15	8
Italian lira	3	2	1	5	4
Other	8	9	5	9	6
Total	**100**	**100**	**100**	**100**	**100**

(a) Excluding equity-related issues.

The euroyen and Samurai markets accounted for 16% of international bond issues in the third quarter. Yen appreciation and expectations (subsequently realised) of a cut in the Official Discount Rate (ODR) stimulated demand for yen assets. Nearly half the issuers were Japanese companies, which benefited from the fact that spreads relative to government benchmarks were considerably tighter in the euroyen market than in the domestic bond market. Non-Japanese borrowers, however, were deterred by yen appreciation and a lack of swap opportunities.

Chart 5
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.

International bond issues in ERM currencies fell sharply in July, as pressures on the ERM mounted. After widening slightly during the period of exchange rate turbulence, European currency yield differentials against the German Bund narrowed and yield curves steepened immediately after the move to wider bands within the ERM. These changes were moderated, however, when it became clear that rates would not fall significantly (see Chart 5). Over the quarter the French franc's share of total issues fell to 8% from its second quarter record of 15%, reflecting reduced confidence in the franc and possibly also the success of the $19 billion 'Balladur bonds' issued in the domestic market in July. By contrast, the share of Deutsche Mark and Swiss franc issues increased (the former despite few issues in July), benefiting from low yields and investor confidence in the currencies. Lira yields were pushed below 10%, helped by a period of relative political stability and high real interest rates. The Bank of Italy relaxed its issuing regulations to permit more than a single bond issue per day.

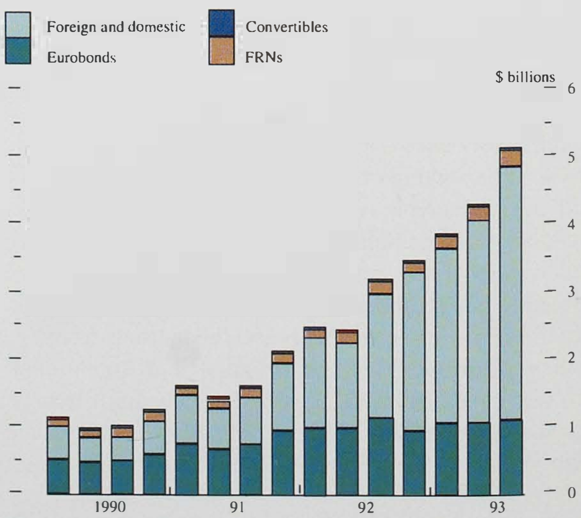
The Bank's monthly ecu Treasury bill auctions continued to be oversubscribed in all three of the maturities at which bills were offered. The August and September auctions were each covered more than 1.7 times and the October auction was covered almost three times. The Bank has continued to offer ECU 200 million of bills at one-month, ECU 500 million of bills at three-months and ECU 300 million of bills at six-months maturity.

The high volume of issues in the sterling markets (both fixed and floating) in the first half of the year continued during the third quarter. In July, 19 new issues were announced, raising £2.5 billion. Despite normally being a quiet month, there was an unusually high amount of new issues in August; 20 were announced, raising £3.7 billion, with the asset-backed sector particularly active (8 issues). The largest debt issue announced in August was by the Kingdom of Denmark, which raised a record £1.3 billion, split into two tranches of £800 million fixed-rate and £500 million floating-rate, as part of its programme to replenish its currency reserves following heavy intervention in the foreign exchange market to support the Danish krone the previous month. September was comparatively quiet, though a variety of different types of issue were brought, including the largest sterling mortgage-backed deal to date (£300 million).

Secondary market turnover

Secondary market trading continued to grow strongly in the third quarter, with a total of $5,200 billion—60% higher than the previous year—settled through Euroclear and Cedel. Nearly all the growth in settlement volumes over recent quarters was accounted for by transactions in domestic government debt held by non-residents, with

Chart 6
Secondary market turnover of international bonds



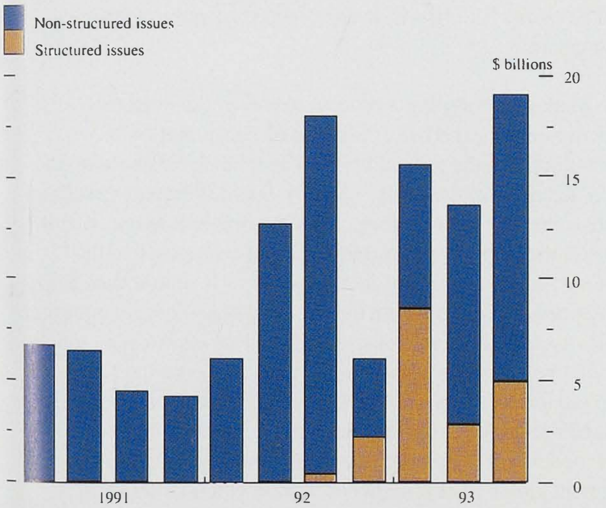
Source: Cedel and Euroclear.

volumes in eurobonds remaining relatively static (see Chart 6).

Floating-rate notes

Floating-rate note (FRN) issuance remained strong in the third quarter at $19 billion (see Chart 7). Expectations of an increase in US short-term rates attracted investors; US dollar-denominated issues accounted for two thirds of the total. Banks and other financial institutions wishing to match floating-rate assets are the traditional issuers of FRNs

Chart 7
Floating-rate note issues



Source: Bank of England ICMS database.

Note: Structured issues may pay minimum and maximum coupons, or may be negatively linked to interest rates.

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

and made up two thirds of new issues in the third quarter. Banks' requirement for fresh capital was another contributory factor; one quarter of their FRN issues ranked as subordinated debt. Structured FRNs (such as 'collared' issues which offer investors maximum and minimum rates of return) rose to $4.9 billion, and continued to be denominated primarily in US dollars, where minimum coupons were often well above short-term interest rates. Issues of reverse FRNs (where the coupon is inversely linked to interest rates) broadened to include Hong Kong dollar and Spanish peseta issues for the first time.

Euromedium-term notes

The attractiveness of the flexibility of euromedium-term notes (EMTNs) to issuers encouraged further growth in the number of programmes being set up. These amounted to $28 billion in the third quarter, four fifths of which were denominated in dollars (although the multicurrency nature of most programmes means that this need not be the currency drawn down), while the value of outstanding EMTN issues rose by $20 billion. The number of issues made from underwritten EMTN programmes rose to 60 in the third quarter (see Chart 8), reflecting their administrative cost advantages over discrete bond issues. Further currencies—including the Belgian franc, Mexican peso and Singapore dollar—were included within EMTN programmes for the first time. The first ever issue by a Latin American sovereign occurred in the third quarter, with the Republic of Argentina's $1 billion programme. The value of sterling medium-term notes (SMTNs) outstanding continued to increase, reaching £6.3 billion by the end of September.

Eurocommercial paper

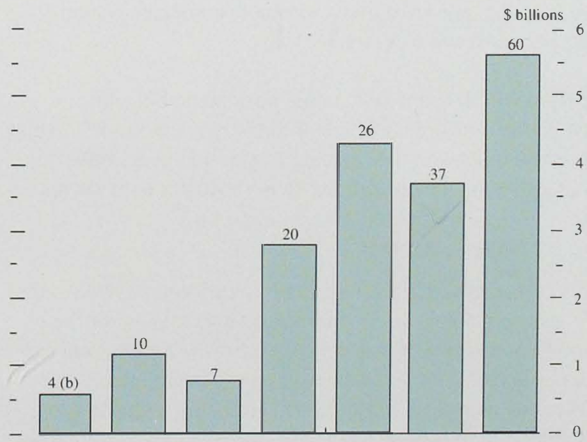
Announcements of new eurocommercial paper (ECP) programmes were relatively subdued, at just $3 billion, although stronger net issuance under existing facilities (raising $5 billion) brought the level outstanding to $81 billion by the end of the third quarter. Low short-term interest rates and the steep yield curve in the dollar (in which most ECP is drawn down) diverted investors to longer maturity paper (such as EMTNs). The value of sterling commercial paper (SCP) outstanding rose to a peak of £6 billion at the end of July before falling to £5.1 billion by the end of September.

The Bank published a consultative document on 23 July proposing a number of changes to the regulations relating to debt issues which are currently set out in The Banking Act 1987 (Exempt Transactions) (Amendment) Regulations 1990 and the Bank's Market Notice dated 11 January 1990. The consultation period ended on 15 September. The Bank is now considering all comments received and will be putting forward its revised proposals in due course.

Syndicated credit activity

The strength of borrowing by US companies, which had inflated syndicated credit activity in the second quarter, faltered in the third. Announced facilities for US companies fell by one half to $18 billion, as total announced syndicated credit facilities remained weak at $52 billion. Demand for syndicated credits has remained depressed largely because of low growth in the major economies, limited merger and acquisition financing and the opportunities for capital market financing, especially for higher-rated companies. Spreads and fees—in particular, for high-quality borrowers—

Chart 8
Issues from underwritten EMTN programmes(a)



Source: Bank of England ICMS database.

(a) Issues from EMTN programmes underwritten by a syndicate of investment banks.
(b) Number of issues.

CREST—taking forward the Task Force recommendations

The report of the Task Force on Securities Settlement was published on 1 July (see box in the August 1993 *Quarterly Bulletin*). Implementation of the recommendations of the Task Force is now under way. The Stock Exchange is working towards the introduction of rolling settlement on a T+10 cycle in July 1994, and the further move to rolling settlement on a T+5 cycle at the end of 1994; the Bank has established a project team to develop a detailed design for CREST, and to monitor and encourage progress towards rolling settlement; and Pen Kent, as the Bank director responsible, has drawn together a Steering Committee of industry representatives to oversee the programme.

The Bank team

Iain Saville has been appointed project controller for CREST. He and his team are to produce a detailed design for CREST which commands the broad support of the equity industry, by 1 May 1994 at the latest. This is a demanding task. The Task Force report, however, provides an extremely solid and well-thought-out framework within which the team will work. The team will only depart from these principles if forced to do so because the difficulties are much more severe than was apparent to the Task Force. Completing this task is vital for the future of the equity industry in the United Kingdom.

To achieve it, the team will focus on key processes, such as trade agreement and stock borrowing. They will propose solutions to difficulties which arise, either in the move to short-period rolling settlement (on T+5) or in CREST, and discuss them with the whole range of industry participants involved in each process. It is the team's objective that those involved in the design process should be as accessible as possible to those affected by their decisions. Within the context set by the Task Force report, the team is keen to encourage ideas from the industry.

The Bank has made available a number of Information Technology experts to support the project team. All have experience of the other settlement systems the Bank has successfully introduced—the Central Gilts Office, Central Moneymarkets Office and, most recently, the European Settlements Office. These IT experts will work closely with the project team, to ensure that the design which the team will evolve can be translated into a workable computer system at reasonable cost and in a credible way.

The team will devote considerable resource to bilateral consultation with a wide range of industry contacts. It will also form close links with the working parties that many trade associations concerned with the equity industry have set up.

The Steering Committee

A key forum in which the team's proposals will be reviewed is the Steering Committee. Its purpose is also to monitor the progress of the project team in specifying the new system and to act as one of several channels of communication with the market. Its members are market practitioners with wide experience, representing a range of interests. They will be able to draw on their professional expertise to give guidance to members of the project team and provide a forum for consultation and discussion. Although selected in their personal capacities and not as delegates for particular constituencies, the members intend to discuss issues widely outside the Committee in order to offer more than purely personal views.

Further support for the team

In addition to drawing on internal IT expertise and the knowledge and views of the Steering Committee, the project team is supported in several ways. It intends to appoint secondees from the industry on a full or part-time basis to help it in its work. The first of these joined the team in late September.

The Bank is developing a process model of the industry, drawing on the expertise of a group of consultants who will work alongside the project team. The model will cover all the main activities in the equity industry, identifying key processes such as register maintenance, stock lending and so on. It will analyse the flows of paper, bargains and cash between the various participant groups in the industry. It should thus help to identify bottlenecks both during the day and over longer time scales such as those relevant to registration; and to examine alternative solutions to those difficulties. The model will thus help the team to explore with the industry the changes which will be needed to move to rolling settlement and then to CREST. The model will not predict the future, but it should provide a coherent and logical framework within which all those involved can think about it.

The team will also have use of legal advice to ensure that all necessary legal changes for CREST are identified and addressed at an early stage.

Rolling settlement

On 5 October the Stock Exchange published its Outline Service Description for the move to T+10 rolling settlement on 18 July next year. This included a timetable for publication of detailed changes to system specifications and Exchange rules which will be required. The Exchange and the CREST project team will continue to work closely together to ensure the smooth implementation of rolling settlement across the industry. The CREST team will address those changes required outside the Exchange by industry participants, particularly for the move to T+5 rolling settlement.

Moving forward

It is the project team's intention that its workings should be as open and public as possible, within the tight timetable to which it is working. The CREST team accordingly welcomes views or reactions from any interested party; these should be addressed to the CREST project team at the Bank of England.

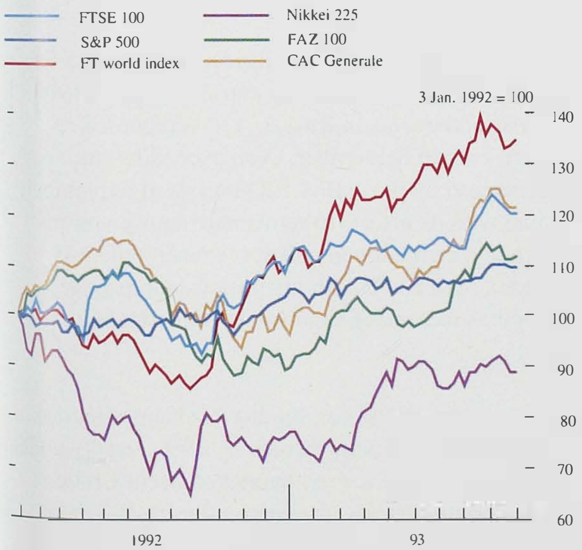
It is clear that the team has an enormous task ahead of it. The Bank is, however, determined that the timetable for rolling settlement and for the CREST design which was set out in the Task Force report will be met. The support of the equity industry is a vital ingredient in achieving this, and the Bank is confident that it can rely on that support.

narrowed slightly after sharp rises in 1992, reflecting weak credit demand and banks' increased demand for highly rated assets. The Spanish government arranged an ECU 5 billion standby credit facility, replacing borrowing from the central bank which will no longer be permitted under the terms of the Maastricht Treaty, followed by a further $4.5 billion facility in September. Asian borrowers remained active and accounted for one sixth of new facilities in the third quarter, with notable increases by Hong Kong and Thai entities.

Equity markets

Share prices rose in all the major equity markets in the third quarter (see Chart 9); the FT-Actuaries world index rose by almost 4% in local currency terms. In Europe, widening of the ERM bands appeared to provide scope for cuts in interest rates, which helped boost share prices and the UK, German and French indices all reached new peaks. Japanese equity prices were underpinned by falls in money-market

Chart 9
Equity indices(a)



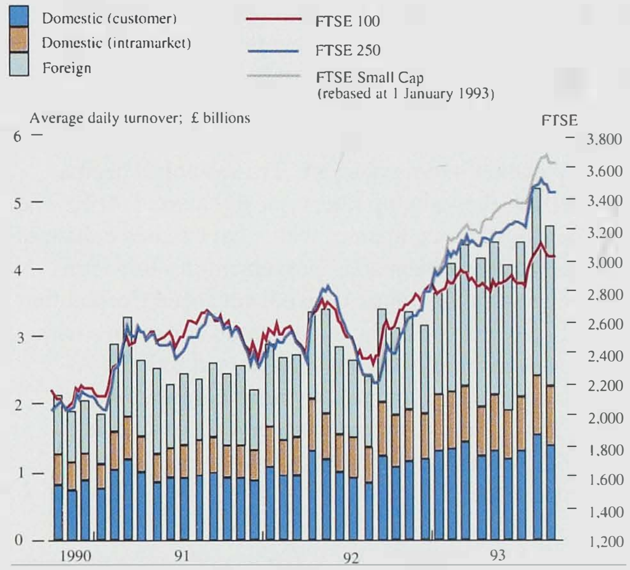
(a) End-week prices.

interest rates, the ODR cut in September and the strength of the yen, all of which encouraged foreign investment. US equity prices showed the weakest growth of all the major markets, depressed by weaker than expected economic conditions and limited potential for further official rate cuts.

In the UK equity market, the FTSE 100 rallied strongly during the third quarter, rising to a new high of 3,100.6 at end-August (see Chart 10). A period of consolidation followed in September as the index fell back towards 3,000, ending the quarter 4% higher than at end-June. The FTSE 250 and Small Cap indices also rose sharply, both ending the quarter 7% higher than at end-June.

With the market moving to new heights, secondary market turnover also reached record levels in the third quarter. Daily turnover in UK stocks averaged £2.3 billion, of which customer business represented £1.4 billion. In line with the rising market and substantial turnover, average trading

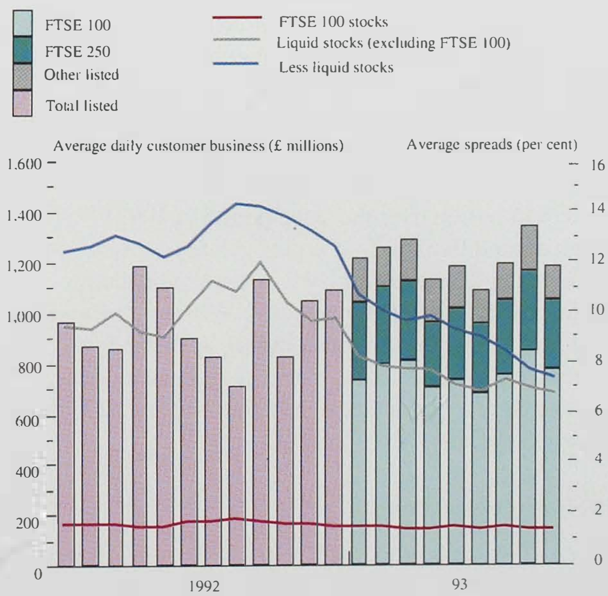
Chart 10
Equity turnover and prices on the London Stock Exchange



spreads continued to narrow, especially for liquid (non-FTSE 100) and illiquid stocks (see Chart 11). Turnover of overseas equities exceeded domestic turnover for the second quarter in a row, averaging £2.5 billion per day. Of this total, turnover in German, Japanese and French equities was particularly strong, making up 14%, 19% and 20% respectively.

Despite the strength of investor demand for UK equities, the new issues market was influenced by seasonal factors and remained relatively subdued in the third quarter. Most deals in July and August were small placings. A number of large rights issues were, however, announced in September as the reporting season got under way, including Scottish and Newcastle (£405 million), Tarmac (£215 million) and Cadbury Schweppes (£333 million).

Chart 11
Average daily customer business and average trading spreads on the UK equity market



Enhanced scrip dividends have been a prominent feature of the London equity market since March 1993. Historically, ordinary scrip dividend schemes have not been especially popular with shareholders, with take-up rates of only 10%–15%. In an attempt to increase take-up, companies have offered enhanced scrip dividends, in which shareholders generally receive shares to the value of 150% of the net dividend cash alternative (or a similar sum in cash offered by market intermediaries). The result has been a substantially higher take-up rate, typically around 90%. The advantages for those companies which have issued enhanced scrip dividends have been an improvement in short-term cash flow and a saving on unrelieved Advanced Corporation Tax (ACT) payments (for those UK-based companies with high overseas earnings which would pay out more in ACT on cash dividends than their mainstream corporation tax liability). Since BAT Industries pioneered the scheme in March 1993, 19 companies have followed, raising the equivalent of over £2 billion.

The London Stock Exchange has announced new post-trade transparency rules, aimed at improving the market's ability to execute very large trades in UK equities, in particular in second and third-line stocks. The proposals, which will take effect from 13 December, are designed to help market-makers unwind positions arising from very large trades by delaying publication of bargain details. Where they execute trades of more than 75 times Normal Market Size (NMS representing the minimum size at which market-makers may quote prices on Topic), which therefore pose a substantial capital risk, market-makers will have the option of delaying publication of the deal until the trade has been 90% hedged or unwound, or after five days, whichever is sooner. A relatively small number of deals of this size are currently done each day, mostly in less liquid shares.

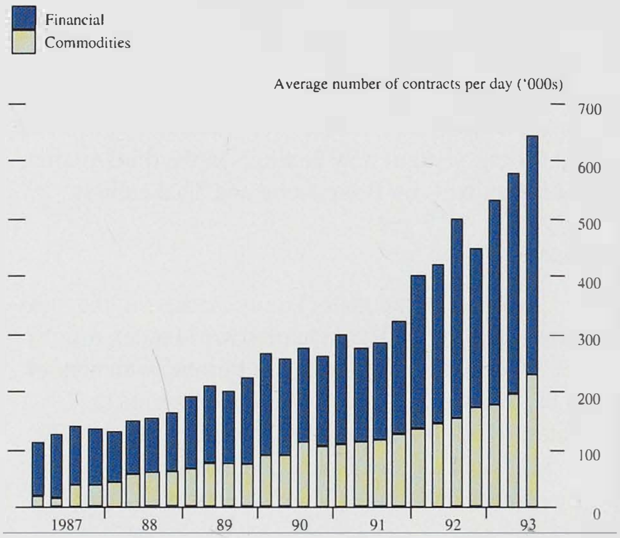
Equity-related bonds

Equity-related bond issues were subdued in the third quarter, reflecting only modest growth in the Japanese equity markets, to which most such issues are linked. Few issues, coupled with high repayments, meant that the value of equity-related bonds outstanding contracted by $14 billion. Borrowers have instead had to use other channels to refinance maturing equity-related debt: at $72 billion, repayment of equity-related debt by Japanese borrowers in the first three quarters of 1993 far exceeded the $47 billion raised by Japanese borrowers through all international bond issuance ($45 billion over the same period in 1992). Although around two thirds of equity-related debt is denominated in US dollars or Swiss francs, demand for equity-linked sterling instruments was confirmed by various types of convertible bonds issued during the period: structures used included convertible subordinated bonds, bonds with equity warrants attached and exchangeable bond issues.

UK derivatives exchanges

Turnover on the four principal London derivatives exchanges (LIFFE, LME, IPE and LCE) rose to record levels in the third quarter (see Chart 12), with both the financial and commodity sectors experiencing strong growth.

Chart 12
Turnover on the London derivatives exchanges



The increase in turnover on LIFFE during the third quarter was largely a result of the volatility caused by the ERM currency crisis and events in Russia. LIFFE recorded its busiest month ever in September, even exceeding the volumes generated by the earlier ERM crisis in September 1992. In line with its efforts to rejuvenate equity options, LIFFE launched a campaign aimed at increasing the use of equity index options by both institutions and private clients as well as increasing liquidity in individual equity options.

Trading volumes on all the commodity exchanges increased in the third quarter. IPE activity rose by 19%, largely owing to the sharp downward price movement of Brent Crude. Interest in the copper backwardation on the LME (where, abnormally, the cash price traded at a premium to the three-month price for a whole month during the quarter), resulted in record turnover, up 16% on the second quarter. LCE activity increased by 35%, led by cocoa and coffee contracts, where activity was fuelled by price increases and the successful negotiation of new international commodity agreements.

Gilt warrants

There has recently been growing interest in the United Kingdom in all forms of warrants: those linked to bonds, currencies or share indices. Since May there has also been renewed interest in gilt warrants, an instrument in which there has been very little activity for several years. Gilt warrants, which give an investor the right, but not the obligation, either to buy (call) or sell (put) the underlying stock against which they are written, differ from OTC options in two principal respects: the majority are listed, which is attractive to those investors which are only permitted to hold such instruments; and they tend to be of longer maturities than OTC options, typically a year or more.

Table C
Gilt warrants outstanding as at end-September 1993

£ millions

Stock	Nominal amount of stock outstanding	Call warrants(a) amount outstanding
7¼% T98	7,850	675
9¾% T02	6,527	200
8% T03	7,700	500
8% T13	4,350	100
8¾% T17	6,500	250
Total		**1,725**

(a) No put warrants have been issued.

The revival of interest in gilt warrants has been spurred by the sustained rally in the gilt market, to which overseas investors have been attempting to gain exposure. When non-sterling based investors buy gilts they may face a currency risk on the full value of the gilt. By purchasing a warrant their currency risk exposure is reduced to the premium paid for the warrant, while they still have the option to benefit from a rise in the gilt market. As can be seen from Table C, the nominal amount of call warrants exercisable into gilts at the end of September this year stood at £1.7 billion. There were no put warrants outstanding.