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2. The international banking market

Purchases of government securities supported activity in the international banking market in the third quarter of 2002. Banks in the BIS reporting area invested substantial amounts in euro area and US government securities and other lower-risk assets. At the same time, cross-border lending to corporations and other banks remained subdued. Thus, bank activity seems to have reflected the heightened sense of risk aversion evident among global investors in the third quarter, when spreads in the corporate bond market soared.

Bank flows to emerging markets in the third quarter also showed a shift towards lower-risk assets. Latin America experienced the largest outflow of funds since the third quarter of 1999, and banks again reduced their cross-border claims on Turkey. By contrast, emerging markets in Asia saw a record inflow of funds, driven by both a rise in claims and a repatriation of deposits. Banks also channelled funds to countries in accession negotiations with the European Union.

Euro area activity picks up

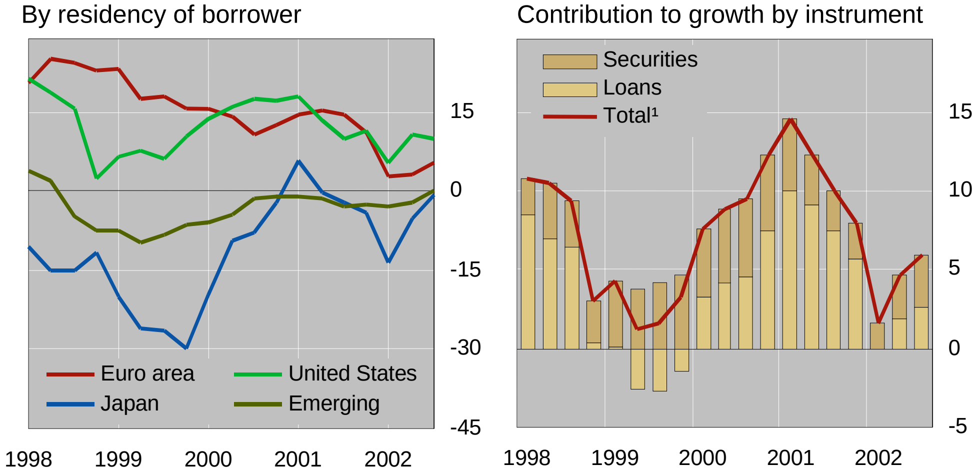
The growth of cross-border bank credit picked up very slightly in the third quarter of 2002, driven by investment in low-risk securities as banks in the BIS reporting area continued to shift their asset portfolios out of loans. The year-over-year growth in claims accelerated to 6%, up from 4.7% in the second quarter (Graph 2.1). In seasonally unadjusted terms, the outstanding stock of cross-border claims booked by banks in the reporting area increased by \$142 billion between end-June and end-September 2002, to \$12.7 trillion (Table 2.1).

Activity shifts from the interbank market

Much of the third quarter increase in total claims reflected investment in government and other debt securities. As discussed in the December 2002 *BIS Quarterly Review*, the growth in claims on non-banks, which include governments and quasi-government agencies as well as corporations, has consistently exceeded that of claims on banks since the second quarter of 2001. Boosted by a \$113 billion investment in debt securities, claims on non-banks increased by \$144 billion in the third quarter of 2002. This was the largest quarterly increase since the first quarter of 2001, and drove up the year-over-year growth rate of claims on non-banks to 9.6%, the third consecutive quarterly increase.

Cross-border claims by residency and instrument

Annual percentage changes[1]



[1] Calculated as the sum of exchange rate adjusted changes in amounts outstanding between periods t–3 and t, divided by the amount outstanding in period t–4.

Graph 2.1

Euro area activity picks up while claims on the US are flat

In terms of the location of borrowers, the pickup in overall activity was largely explained by robust activity in the euro area. Claims rose 5.5% year over year following two quarters of slow growth. Much of this expansion was driven by intra-euro area activity, as banks in Germany, France, Italy and Spain each increased claims on the area by $9 billion or more. The contraction in claims on borrowers in Japan observed in previous quarters appeared to come to a halt in the third quarter of 2002. Banks in the reporting area extended new loans to non-bank borrowers, pushing year-over-year total loan growth into positive territory for the first time since the second quarter of 2001. At the same time, following six quarterly increases, total claims on borrowers in the United States slowed considerably. A $43 billion rise in claims on US non-bank borrowers, much of it in the form of claims on the public sector, was completely offset by a reduction in loans to the banking sector, which largely reflected inter-office activity.

Euros are the currency of choice

Consistent with the increased activity in the euro area, claims in the international banking market continued to shift out of US dollars and into euros, while yen-denominated claims stabilised. Claims denominated in US dollars fell by $92 billion, the largest quarterly decrease since early 1999, and now comprise 43% of the stock of international claims (down from the peak of 46% in the first quarter of 2002). Conversely, euro-denominated claims expanded by $216 billion in the third quarter, the largest quarterly expansion in six quarters.

Banks park funds in government and other debt securities

Four fifths of the increase in claims in the third quarter of 2002 reflected investment in debt securities. While loans continued to be the primary claim instrument, the share of debt securities in total claims has risen, reaching 21% in the third quarter compared to 19% in mid-2001. A disproportionate amount of

Cross-border claims of BIS reporting banks

Exchange rate adjusted changes in amounts outstanding, in billions of US dollars[1]

	2000	2001	2001		2002			Stocks at end-Sep 2002
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Total claims	1,221.5	859.4	–12.0	236.8	45.8	246.1	141.7	12,694.1
By instrument								
Loans and deposits	738.0	612.2	–52.1	165.5	–9.9	102.5	36.6	9,446.4
Securities[2]	483.5	247.2	40.1	71.3	55.7	143.6	105.2	3,247.7
By currency								
US dollar	513.0	423.7	13.3	184.5	48.2	192.7	–92.1	5,414.1
Euro	455.6	439.3	46.5	–12.2	43.6	106.2	215.8	4,101.6
Japanese yen	94.6	–65.3	–50.9	6.6	–81.5	5.3	15.7	707.3
Other currencies[3]	158.3	61.7	–20.9	57.9	35.5	–58.1	2.3	2,471.1
By sector of borrower								
Own offices	523.0	467.0	–22.3	365.0	–2.1	82.6	0.9	4,224.8
Other banks[4]	409.7	–49.7	–3.2	–222.9	0.1	80.6	–3.2	4,061.2
Non-banks	288.8	442.1	13.5	94.7	47.8	82.9	144.0	4,408.1
By residency of borrower								
Advanced economies	1,126.4	804.4	5.3	202.2	35.3	214.6	156.7	9,977.0
Euro area	389.1	368.7	9.2	8.4	55.2	36.6	97.7	4,083.6
Japan	–12.0	–23.3	–24.6	28.0	–52.3	22.2	–0.1	513.7
United States	309.0	236.6	16.6	73.8	14.4	133.9	0.3	2,528.4
Offshore centres	51.5	55.3	3.2	24.9	–7.3	25.2	–17.2	1,527.5
Emerging economies	–7.9	–23.3	–18.6	1.4	–3.1	3.4	–2.3	881.5
Unallocated[5]	51.5	23.0	–1.9	8.4	20.8	2.9	4.6	308.1
Memo: Local claims[6]	*207.1*	*90.4*	*–1.2*	*–0.1*	*66.1*	*–40.2*	*–26.5*	*1,634.9*

[1] Not adjusted for seasonal effects. [2] Mainly debt securities. Other assets account for less than 5% of total claims outstanding. [3] Including unallocated currencies. [4] Borrowers other than own offices, official monetary authorities (eg central banks) and non-banks. Owing to errors and omissions, claims on other banks reported above may differ from data reported in Table 8 in the Statistical Annex. [5] Including claims on international organisations. [6] Foreign currency claims on residents of the country in which the reporting bank is domiciled. Table 2.1

this shift to debt instruments took the form of claims vis-à-vis the non-bank sector, as banks in the reporting area increased their investment in agency and government debt. Reflecting this shift, the share of debt securities increased from 36% of all claims on non-banks in early 2001 to just over 40% in the third quarter of 2002. At the same time, the share of these instruments in claims on banks has remained relatively constant since early 2001.

Banks shift to government and other low-risk debt securities

In the light of the overall depressed economic conditions in the third quarter of 2002, the increased investment in debt securities is consistent with banks reducing credit risk by placing a larger share of assets in government debt. The BIS consolidated statistics, which net out inter-office positions, indicate that the shift towards securities largely took the form of claims on the public sector. Claims on the public sector accounted for 12.6% of total international consolidated claims in the third quarter of 2002, up from 11.8% a year earlier. At the same time, claims on unrelated banks have continued to fall as a share of outstanding international claims.

The shift from loans to securities has been particularly evident in claims vis-à-vis the euro area. The year-over-year growth in total claims on euro area non-bank borrowers has exceeded 11% every quarter since 1996. However, in recent quarters, this growth was driven by relatively large increases in debt security claims (as opposed to new loans). Investment in euro area government (and corporate) debt securities was up by $55 billion in the third quarter of 2002, the largest rise since the first quarter of 1999. Consistent with this, the BIS consolidated data indicate relatively large increases in claims on the public sectors of the major euro area countries. Banks in the reporting area expanded their claims on the euro area public sector by approximately $22.5 billion in the third quarter, with claims of euro area banks accounting for $9.5 billion of the total. German, Dutch and Italian banks were particularly active. In addition, investment by Japanese banks totalled $17 billion, and accounted for nearly 75% of the increase in claims on the euro area public sector.

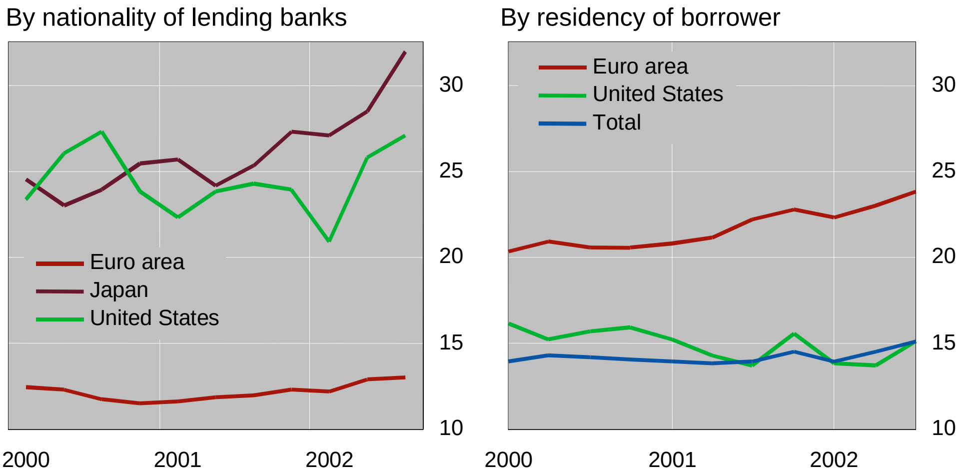
Claims on the euro area public sector rise ...

The shift into agency and government securities helped to reverse the fall in Japanese banks' total credit, which rose for the first time in six quarters. The positive third quarter flow slowed the year-over-year rate of contraction to 8% from approximately 14% in the previous two quarters. Claims on unrelated banks continued to contract. However, claims on the public sector and other non-bank borrowers expanded by a robust $64 billion, and now comprise more than 50% of Japanese banks' total claims (from 45% a year earlier). The consolidated data indicate that Japanese banks (as well as mutual and pension funds through trustee banks) purchased approximately $43 billion in government securities, up 17% from the previous quarter (Graph 2.2). Excluding the local currency claims of Japanese banks' offices located outside Japan, Japanese banks' claims on foreign governments reached $296 billion, or 32% of their total international claims (up from 25% a year earlier). In particular, credit to the US public sector grew to $150 billion, or 40% of all

... as Japanese banks step up purchases of government debt ...

Consolidated international claims on the public sector[1]

In percentages



[1] As a percentage of international claims.

Graph 2.2

Japanese international claims on the United States. Japanese banks also increased credit to the German, French and Italian public sectors.

... and US banks reduce claims on other banks

A shift towards public sector claims was also evident for US banks. On a consolidated basis, the share of claims on the public sector grew to 27% of US banks' total international claims in the third quarter of 2002, up from 24% a year earlier. Driving this expansion, however, was not an increase in investment in government securities, but rather relatively large reductions in claims on unrelated banks and the non-bank private sector. In the third quarter, US banks reduced cross-border credit to corporations by $19 billion, contributing to a 12% year-over-year contraction. At the same time, credit to banks fell 15% year over year, while claims on the public sector remained stable. Overall, US banks' cross-border claims stood at $424 billion, the lowest level since the fourth quarter of 2000.

Emerging markets

The net flow of funds into emerging markets from banks in the BIS reporting area was positive in the third quarter, although differences across regions were significant. Funds flowed out of Latin America, emerging Europe, and the Middle East and African regions, but were offset by a $26 billion inflow into Asia (Graph 2.3). Relatively large deposit repatriations in both the Asia-Pacific and Latin American regions drove the overall net inflow. Claims on emerging markets contracted slightly from the second quarter, falling to $882 billion, largely the result of credit reductions to the major Latin American countries.

Claims on Latin America at lowest level in six years

The net flow of funds to Latin America remained negative for the second consecutive quarter, at $2.9 billion. Claims contracted by 4%, to $269 billion, the lowest level since the third quarter of 1996. Banks in the reporting countries continued to reduce exposure to all sectors in Latin America, with cross-border claims on the banking sector declining more rapidly than claims on the public or non-bank private sectors.

Argentina sees a large net outflow ...

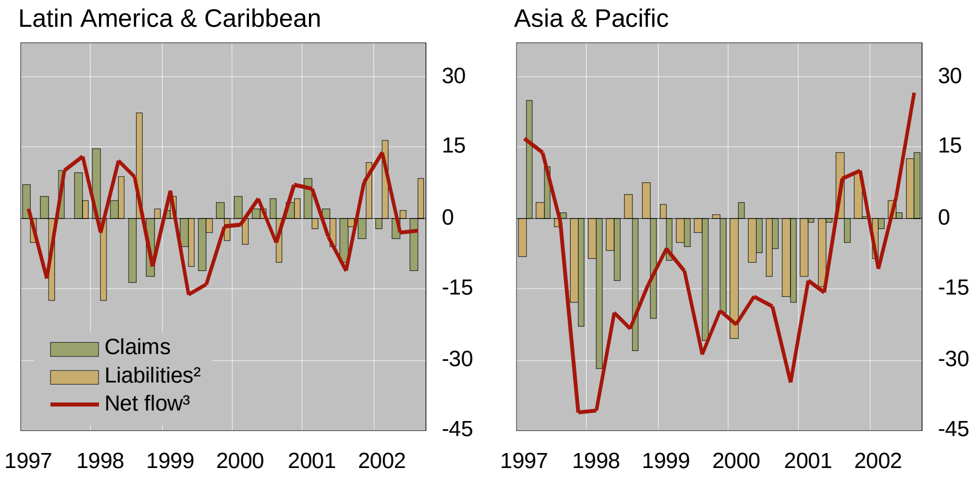
While the concerns of global investors had shifted from Argentina to Brazil by the third quarter, the outflow from Argentina was the largest in the region. The country recorded the largest outflow of funds ($4.7 billion) since the beginning of the financial crisis in the third quarter of 2001. This was driven by a cutback in claims and writedowns of non-performing loans. While the rate of contraction in claims on Argentine non-banks slowed, the rate of contraction in claims on the banking sector picked up. The third quarter of 2002 saw a decrease of $2.9 billion, the largest for the Argentine banking sector in the BIS coverage period. While banks located in virtually every reporting country cut back their claims on Argentina, banks in the United States reduced claims the most. Undisbursed credit commitments to Argentina also continued their downward slide, falling to $2.5 billion from $7.7 billion a year earlier.

... as do Brazil and Mexico

In Brazil, funds flowed out of both the bank and non-bank sectors, contributing to a net outflow of $2.4 billion, also the largest since the third

Net bank flows to emerging economies[1]

Exchange rate adjusted changes in amounts outstanding, in billions of US dollars



[1] A positive value represents an inflow to emerging economies from banks in the BIS reporting area, and a negative value an outflow from emerging economies. [2] A positive value indicates a decrease in BIS reporting banks' liabilities vis-à-vis emerging economies, and a negative value an increase. [3] Changes in claims minus changes in liabilities.

Graph 2.3

quarter of 2001. The year-over-year rate of contraction in claims on Brazil accelerated from the previous quarter, rising to 7.3% from 4.8% in the previous quarter, as US, German and Spanish banks cut short-term credit. In particular, claims on the banking sector fell by 8% year over year, following two quarters of relative stability. In addition, undisbursed credit commitments contracted for the fourth consecutive quarter.

Like Argentina and Brazil, Mexico also experienced a net outflow of funds, as total claims contracted by $1.9 billion from the previous quarter. Claims on the banking sector dropped by 26% year over year, reflecting a reduction in the short-term positions of Spanish banks. As a result, claims on the banking sector reached a new low of 12% of total claims, down from 17% a year earlier. Following three quarters of modest growth, claims on non-banks also fell slightly in the third quarter, as banks in the reporting area continued to unload debt securities issued by this sector.

Record net inflow into the Asia-Pacific region

Asia withdraws deposits

A record $26 billion flowed into the Asia-Pacific region in the third quarter of 2002, larger even than the inflow observed in the second and third quarters of 1996. The inflow was driven by large deposit repatriations by the region's banks, as well as a $13.8 billion increase in claims, much of it in the form of loans to bank borrowers. Reflecting the flow of funds to the region's banking sector, consolidated cross-border claims on the region's non-bank private sector fell to 46% of total claims, down from 50% a year earlier. In addition, claims have continued to shift towards shorter-term maturities; claims with a maturity of one year or less comprised 52% of international claims on the region, up from 50% in the second quarter.

Cross-border bank flows to emerging economies

Exchange rate adjusted changes in amounts outstanding, in billions of US dollars

	Banks' position[1]	2000	2001	2001		2002			Stocks at end-Sep 2002
		Year	Year	Q3	Q4	Q1	Q2	Q3	
Total[2]	Claims	–7.9	–23.3	–18.6	1.4	–3.1	3.4	–2.3	881.5
	Liabilities	140.1	23.1	–15.0	–27.6	–8.6	–4.8	–20.5	1,075.6
Argentina	Claims	1.2	–5.8	–2.4	–3.3	–4.3	–0.8	–4.4	31.7
	Liabilities	3.1	–16.7	–1.9	–11.1	–1.0	0.5	0.3	23.6
Brazil	Claims	9.5	0.9	–1.1	–2.2	1.0	–2.4	–3.6	91.8
	Liabilities	–4.6	0.4	4.9	–4.1	1.4	–3.8	–1.2	44.4
Chile	Claims	0.3	0.2	–0.9	0.2	–0.3	–0.5	0.1	18.3
	Liabilities	–1.5	–1.0	–0.4	–0.6	0.2	–0.8	–0.9	13.3
China	Claims	–5.4	–3.5	–2.6	–0.6	–7.3	1.0	4.1	53.5
	Liabilities	35.7	–6.5	–6.7	–4.0	–7.1	6.4	–0.9	93.8
Indonesia	Claims	–3.6	–5.4	–2.3	–0.8	–1.3	–2.1	–1.3	31.8
	Liabilities	–1.0	1.1	–0.4	0.7	–1.4	–0.3	–0.2	12.3
Korea	Claims	–4.8	–0.2	0.8	–2.0	6.4	1.8	6.5	78.7
	Liabilities	–1.7	1.7	–2.4	1.7	11.4	–5.6	–0.4	35.0
Mexico	Claims	–1.0	2.0	–3.3	0.6	3.2	1.8	–1.9	63.6
	Liabilities	6.9	8.8	4.5	0.6	–14.1	1.3	–0.2	50.1
Russia	Claims	–6.6	1.3	0.2	2.1	1.4	0.8	–1.1	31.9
	Liabilities	7.2	5.2	–2.8	1.7	3.6	0.0	4.0	36.5
Saudi Arabia	Claims	0.1	–2.4	–1.6	1.0	0.0	0.4	–1.8	23.1
	Liabilities	10.9	–9.7	–5.7	–7.3	–5.4	–0.1	1.4	48.6
South Africa	Claims	0.6	–0.4	0.8	–1.1	–1.5	0.2	–0.6	16.5
	Liabilities	0.4	2.1	1.1	–0.9	0.2	1.4	–0.3	18.1
Thailand	Claims	–7.8	–3.5	–3.1	1.4	–2.2	–0.5	–0.5	20.6
	Liabilities	1.9	1.3	–0.5	0.5	–0.7	–1.2	–1.4	12.5
Turkey	Claims	11.3	–12.0	–0.9	–3.7	0.9	–1.5	–2.1	35.4
	Liabilities	2.3	–2.1	0.8	–2.1	1.6	–1.9	–0.2	18.7
Memo:									
EU accession countries[3]	*Claims*	*7.5*	*6.3*	*–0.4*	*4.1*	*1.4*	*1.9*	*3.3*	*84.6*
	Liabilities	*5.5*	*9.9*	*0.9*	*4.8*	*–0.3*	*0.6*	*–1.3*	*65.4*
OPEC members	*Claims*	*–11.5*	*–14.0*	*–5.2*	*1.1*	*3.0*	*–0.2*	*–4.6*	*128.4*
	Liabilities	*37.7*	*–2.8*	*–9.7*	*–8.5*	*–5.5*	*–2.5*	*–1.8*	*240.1*

[1] External on-balance sheet positions of banks in the BIS reporting area. Liabilities mainly comprise deposits. An increase in claims represents an inflow into emerging economies; an increase in liabilities represents an outflow from emerging economies. [2] All emerging economies. For details on additional countries, see Tables 6 and 7 in the Statistical Annex. [3] Countries in accession negotiations with the European Union, ie Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic and Slovenia. Table 2.2

Record inflow to the region supported by claims on Taiwan ...

Taiwan, China experienced a net inflow of $10.7 billion, the largest of any economy in the region, as funds flowed into both the bank and non-bank sectors. The inflow to banks was the result of roughly $5 billion in US dollar-denominated deposit repatriations. Conversely, the net inflow into the non-bank sector resulted from $3.4 billion in new loans. In addition, Taiwanese firms were active in the syndicated loan market in the third quarter, signing $1.6 billion in new facilities. Most of this went to electronics firms.

The resurgence in claims on South Korea that had started in the first quarter of 2002 continued through the third. Total claims rose by $6.5 billion, the largest increase in absolute terms since the onset of the regional currency crisis in 1997. Roughly half of this went to non-bank borrowers, reflecting the robust growth in domestic bank lending that continued through the third quarter of 2002. South Korean firms also signed $2.5 billion in syndicated credits, the largest increase since the fourth quarter of 2000, with transportation, oil refining and mining firms accounting for roughly half the total.

... and South Korea

The net flow of funds into China also turned positive, at $5.1 billion, driven by increased claims on the country's banking sector. Following two quarters of relatively large decreases, claims on China's banking sector increased by $4.9 billion. Much of the activity seems to have been driven by inter-office activity between banks located in the United States, United Kingdom and offshore centres vis-à-vis their offices in China.

Net inflow to EU accession countries, but overall outflow from emerging Europe

The net flow of funds to emerging markets in Europe turned negative in the third quarter of 2002, despite inflows to several countries in EU accession negotiations. Claims on the region contracted by $1.8 billion as banks in the reporting area reduced loans to the region's banking sector. As in Latin America, the share of claims on the banking sector in European emerging markets has continued to fall, sinking to 25% of cross-border claims in the third quarter of 2002 from 32% a year earlier.

Funds flow out of Turkey and Russia ...

Turkey experienced a net outflow, as claims contracted by $2.1 billion to $35.4 billion. While claims on Turkey's non-banks have remained stable, claims on resident banks fell to $6.7 billion, and comprised 19% of total claims (down from 29% a year earlier). Russia also experienced a net outflow of $5 billion, the largest since the first quarter of 2001. Claims on Russia contracted by $1.1 billion, after five consecutive quarters of expansion, as loans to the banking sector were reduced. A $2.8 billion increase in euro-denominated deposits with banks in developed Europe contributed to the net outflow. Deposits and other liabilities placed in reporting area banks by banks in Russia have been on an upward trend since the fourth quarter of 1998, and have continued to migrate from banks in the United States to banks resident in Europe.

... but into Poland, Hungary and the Czech Republic

In contrast to Turkey and Russia, bank flows to the 12 countries in EU accession negotiations reached $4.6 billion. Claims on these countries have trended upwards since the second quarter of 2000. Activity in most of the accession countries was stable, while Poland, Hungary and the Czech Republic all experienced net inflows. Polish banks repatriated $867 million in deposits from banks in Germany and the United States, while claims on Polish borrowers rose as banks in the euro area purchased local currency denominated debt securities. Banks in the Czech Republic also repatriated $1.1 billion in deposits from euro area banks, while claims on Czech bank and non-bank borrowers expanded modestly. Claims on Hungary rose by $1.3 billion, as banks in the reporting area invested in debt securities, and extended $830 million in loans to the banking sector.

International syndicated credits in the fourth quarter of 2002

Blaise Gadanecz

Signings of international syndicated loans reached $312 billion in the fourth quarter of 2002, down by 7% from the fourth quarter of 2001. Electrical utilities and oil companies were the most active borrowers. Among these borrowers, E.ON of Germany signed the largest facility, for €15 billion, followed by Italy’s Enel and Germany’s RWE at €5 billion each. There was also intense activity in syndications related to leveraged buyouts. A €3.8 billion facility was arranged to buy out the Irish packaging company Jefferson Smurfit, and a €2.8 billion facility to purchase the French electronics firm Legrand.

For the year as a whole, signings declined for the second consecutive period. Following a 5% contraction in 2001, the total volume of new facilities was down by 7% in 2002, to $1.3 trillion. Refinancing reached a record high of $509 billion, suggesting that net new financing raised in the international syndicated loan market fell by even more than gross signings. Borrowing by US entities was 13% lower than the previous year, at $745 billion. By contrast, borrowing by European entities was up by 13%, to $385 billion. Much of the increase in syndicated lending to European companies appears to have been driven by a shift on the part of banks away from bilateral loans and towards syndicated loans.

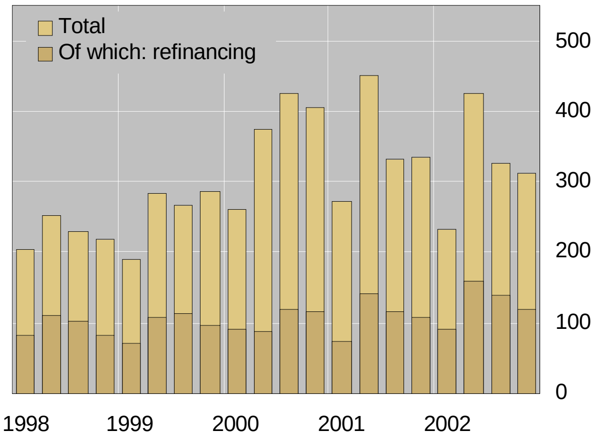
Emerging markets raised $17 billion in the international syndicated loan market in the fourth quarter of 2002. South Korean borrowers – mainly banks and consumer finance or credit card companies – were the most active, raising $3.5 billion. Taiwanese firms, mostly in the electronics industry, raised $1.3 billion. In Latin America, Mexican corporations closed facilities totalling $2.4 billion. An Argentine oil company, Pecom Energía, tapped the syndicated loan market to refinance bilateral loans totalling $600 million, prior to Petrobras of Brazil acquiring a controlling stake in the company. Turkish banks borrowed $1 billion, mainly to refinance maturing syndicated facilities.

For 2002 as a whole, lending to borrowers outside industrialised countries was more or less unchanged compared to 2001. Signings by borrowers in Latin America fell by 50% from 2001, to $11 billion. Borrowing by Argentine residents had already dropped off sharply in 2001 and all but ceased in 2002. Brazilian and Mexican borrowers raised about half the amounts arranged in 2001. The state oil company Pemex was the most active Mexican borrower in the market, and construction materials and energy firms the most active Brazilian borrowers. The decline in activity in Latin America was offset by increased activity in other regions. Fund-raising by Hong Kong and Singaporean borrowers – at $17 billion and $3 billion respectively – was modest compared to 2001, reflecting lower demand for real estate development financing. Yet lending to emerging markets in Asia increased by one third, to $28 billion, boosted especially by signings for Korean financial institutions and Taiwanese corporations. In Europe, a large volume of facilities was arranged for Russian entities, mainly for oil and gas projects.

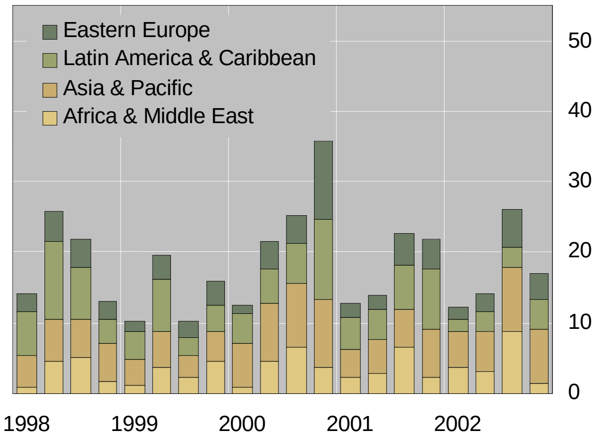
Activity in the international syndicated credit market

In billions of US dollars

Signed facilities



Emerging market borrowers



Sources: Dealogic Loanware; BIS.