Patrick McGuire

+41 61 280 8921
patrick.mcguire@bis.org

2. The international banking market

Following a large contraction in the third quarter of 2003, activity in the interbank market in the fourth quarter returned to levels seen earlier in the year. US dollar-denominated claims led the recovery, as banks in offshore centres, the United Kingdom and the euro area lent to one another and to banks in the United States. The rise in interbank claims was driven not so much by the usual inter-office flows, but by new lending to other banks. Loans to non-bank borrowers, which had displayed signs of life in the third quarter, stagnated in the fourth; the modest increase that did materialise largely took the form of lending from offshore centres to borrowers in the United States, as well as new loans to non-banks in other financial centres.

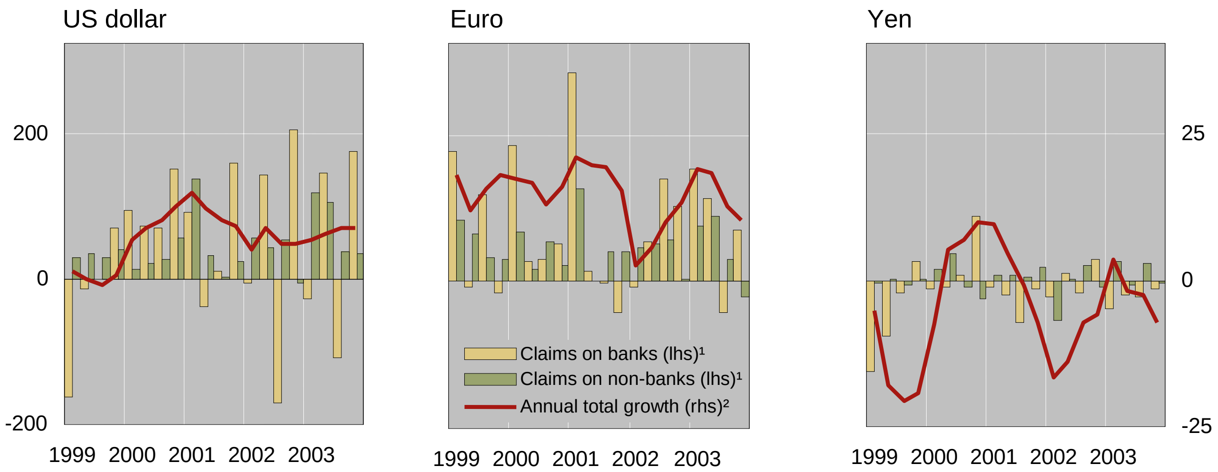
While less pronounced than in previous quarters, a discernible shift within banks' exposures to emerging markets into somewhat safer credits continued in the fourth quarter. This shift was visible in a fall in the share of claims on Latin America as well as a rise in the share of claims on the public sector in certain regions. Moreover, the average rating of the overall emerging market portfolio further improved, partially reflecting rating upgrades of several emerging market sovereign borrowers. These trends in bank flows occurred against a background of falling spreads and robust issuance of debt securities by emerging market borrowers.

In the fourth quarter of 2003, an expansion in deposits placed with BIS reporting banks outpaced one in lending, resulting in an overall net outflow from emerging market economies. Increased deposits with reporting area banks contributed to net outflows from Asia-Pacific, Latin America and the Middle East and Africa, while a rise in claims on emerging Europe led to a net inflow there.

Interbank market activity recovers

Lending between banks recovered strongly in the fourth quarter of 2003, pushing activity in the interbank market to levels seen earlier in the year. Fuelled by US dollar-denominated business (Graph 2.1), total claims of BIS reporting banks rose by $313 billion, although the year-over-year growth in claims fell for the second consecutive quarter from 9% to 8%. The tentative signs of a pickup in corporate loan demand that had been noted in the third

Cross-border claims by sector and currency



[1] Exchange rate adjusted changes in amounts outstanding, in billions of US dollars. [2] 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, in per cent.

Graph 2.1

quarter failed to solidify in the fourth, with loans to non-bank borrowers rising only modestly.

London provides the setting for the interbank recovery

Lending in the interbank market recovers in the fourth quarter ...

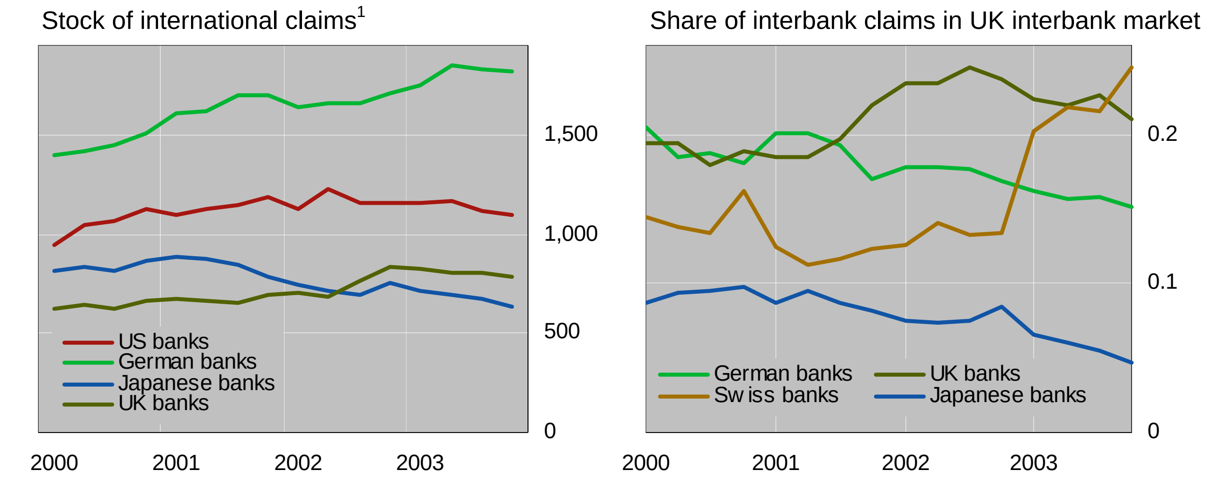
Having declined substantially in the third quarter, interbank activity resumed in the fourth, returning total credit to the elevated levels reached earlier in the year. Interbank claims rose by $276 billion, with lending by banks located in the United Kingdom, Belgium and offshore centres accounting for over two thirds of the increase (Table 2.1). Much of this flowed into banks in the United Kingdom, the euro area and offshore centres. Interestingly, four major national banking systems (UK, US, Japanese and German banks) largely remained on the sidelines; the global interbank claims of banks headquartered in these countries fell, some of them for a second consecutive quarter (Graph 2.2, left-hand panel).

... despite a fall in inter-office activity

Despite the recovery, claims on own offices, typically the dominant component of interbank loan flows, actually decreased in the fourth quarter. Globally, Swiss and US banks cut inter-office activity the most, contributing to a $25 billion fall in inter-office claims. Excluding these claims, new business in the interbank market rose by $194 billion, driven by Swiss banks' lending out of their offices in London ($137 billion) and Belgian banks' lending out of home offices ($70 billion).

Not all banks that had reduced claims in the previous quarter returned to the interbank market in the fourth. In their global operations, Japanese, German and US banks experienced a second consecutive contraction in interbank claims. Once the largest players in London's interbank market, Japanese banks continued to reduce their international activities; four consecutive quarterly declines pushed the share of Japanese banks' interbank claims from their offices in London to 5% of all interbank claims booked in

Interbank claims by nationality of banks



[1] Exchange rate adjusted outstanding amounts, base period 2003 Q4, in billions of US dollars. Graph 2.2

London, down from 8% a year earlier (Graph 2.2, right-hand panel).[1] German banks saw a second quarterly decline despite a relatively substantial rise in inter-office claims. Globally, their lending to other banks fell by $70 billion, the result of reduced interbank credit from their home offices and their offices in London. US banks lowered inter-office claims by $41 billion, but increased loans to other banks by $19 billion, virtually all of which was booked in offices in offshore centres.

Loans to private customers stagnate

A modest rise in loans to non-bank customers ...

Following a comparatively large increase in the third quarter, loans to non-bank borrowers stagnated in the fourth. Total claims on non-banks were up by $37 billion, less than two thirds of which actually took the form of new loans. However, this rather modest aggregate growth masks some relatively large underlying movements. In particular, total claims in US dollars rose by $35 billion, despite a notable contraction in claims by banks in the United States, while euro-denominated claims declined for the first time since the introduction of the euro.

Banks in the reporting area seemed to have halted their tentative advance in international lending to corporate and other non-bank private sector borrowers in the fourth quarter. A resumption of Japanese banks' investment in US Treasury and other debt securities vis-à-vis the United States accounted for a large part of the $35 billion overall increase in US dollar-denominated claims. The BIS consolidated data indicate that Japanese banks' international claims on the US public sector rose by $11 billion to $191 billion, or 47% of their total international claims on the United States.[2]

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[1] Ten years ago, Japanese banks, the largest in London at the time, accounted for no less than 26% of all interbank claims booked in London.

[2] Their claims on the EU public sector rose as well, particularly vis-à-vis Germany, Italy and the United Kingdom.

Cross-border claims of BIS reporting banks

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

	2002	2003	2002	2003				Stocks at end-Dec 2003
	Year	Year	Q4	Q1	Q2	Q3	Q4	
Total cross-border claims	742.4	1,024.6	367.2	336.3	494.6	–119.3	313.0	15,928.9
on banks	427.2	482.2	344.3	135.2	308.5	–237.2	275.7	10,255.8
on non-banks	315.2	542.4	22.9	201.1	186.0	118.0	37.3	5,673.1
Loans: banks	397.4	397.1	422.7	109.3	322.7	–274.6	239.6	8,767.3
non-banks	103.8	279.9	–5.5	156.8	14.9	83.8	24.3	3,034.8
Securities: banks	36.3	89.5	–51.8	18.5	–4.6	25.4	50.2	1,064.1
non-banks	202.2	202.6	27.9	55.4	133.0	15.2	–1.0	2,344.4
Total claims by currency								
US dollar	321.4	486.7	201.2	92.8	253.0	–68.7	209.7	6,285.9
Euro	453.3	472.7	107.7	229.6	203.3	–11.3	51.2	5,977.8
Yen	–40.3	–52.5	19.8	–12.2	–24.9	0.2	–15.6	781.2
Other currencies[2]	8.0	117.7	38.5	26.1	63.2	–39.5	67.7	2,884.0
By residency of non-bank borrower								
Advanced economies	315.1	454.7	75.0	148.6	160.0	101.8	44.3	4,449.3
Euro area	117.4	154.5	6.1	57.2	67.6	50.4	–20.7	2,007.0
Japan	4.1	37.7	0.5	21.5	15.6	6.5	–5.9	181.1
United States	153.1	180.2	59.1	25.8	60.0	40.9	53.6	1,508.4
Offshore centres	18.8	101.2	–28.2	80.9	18.9	10.2	–8.8	623.9
Emerging economies	–16.5	5.1	–23.8	–6.2	3.3	4.9	3.1	546.3
Unallocated[3]	–2.2	–18.6	–0.1	–22.2	3.8	1.1	–1.3	53.6
Memo: Local claims[4]	*44.5*	*413.7*	*36.1*	*180.6*	*88.8*	*51.7*	*92.5*	*2,339.3*

[1] Not adjusted for seasonal effects. [2] Including unallocated currencies. [3] Including claims on international organisations. [4] Foreign currency claims on residents of the country in which the reporting bank is domiciled. Table 2.1

Moreover, the BIS consolidated data indicate that portfolio shifts towards the non-bank private sector, while apparent in several euro area countries in the third quarter, remained stable vis-à-vis this sector for most banking systems in the fourth. Although US banks did raise their exposure to this sector, $16 billion of their $26 billion in new international claims flowed to such borrowers in the United Kingdom, offshore centres (primarily the Cayman Islands) and Luxembourg, suggesting that increased credit ties with non-bank financials was responsible.[3]

[3] Lending to the non-bank private sector rose to 47% of US banks' total international claims, up from 46% in the previous quarter. Another notable exception was UK banks. Increased credit to the non-bank private sector in the United States and the euro area boosted the share of UK banks' international claims on these borrowers to 46% of their total international claims, from 44% in the previous quarter.

... largely reflects non-bank financial activity

Overall, activity involving offshore and other major financial centres, either as lenders or borrowers, remained significant in the fourth quarter.[4] Banks in offshore centres accounted for a rise in lending to non-bank borrowers in the United States, extending $40.5 billion in loans, which possibly reflected the funding of affiliated securities houses and hedge fund activity. At the same time, banks in the United States reduced loans to non-bank borrowers in offshore centres by $22 billion; excluding this move, loans to these borrowers in offshore centres rose by $3.6 billion, mainly as a result of credit from banks in the United Kingdom and the euro area. Claims on non-bank customers in other major financial centres also increased. Banks in the reporting area, primarily in the euro area and the United States, directed $19 billion in new loans to non-banks in the United Kingdom. Similarly, banks in the United Kingdom and the euro area channelled $12 billion to non-banks in Luxembourg.[5]

Euro-denominated debt securities decline following the Parmalat accounting scandal

Total euro-denominated credit to non-banks fell for the first time in the BIS coverage period. The overall decrease in the fourth quarter was the result of a significant reduction in holdings of international debt securities. In a quarter in which the accounting irregularities in the Italian food conglomerate Parmalat became public, BIS reporting banks' holdings of debt securities issued by non-bank residents in Italy fell by $24 billion. Banks in the United Kingdom and France reduced holdings the most, followed by those in Germany, the Netherlands and Spain. As a consequence, euro-denominated debt security claims on the Italian non-bank sector fell to $324 billion, or 24% of all euro-denominated debt security claims on this sector (from 25% in the previous quarter and 28% a year earlier).[6] Euro-denominated loans were up by $13 billion, but were buoyed by new lending to non-banks in Luxembourg. Elsewhere, an $11 billion reduction in euro-denominated loans to non-banks in Germany was partially offset by increased credit to these borrowers in Portugal, Greece, Ireland and Sweden.

Emerging markets increase deposits

Funds flowed out of emerging economies for the second consecutive quarter, although regional differences were apparent. A relatively large rise in deposits placed with reporting area banks by residents in emerging markets outpaced

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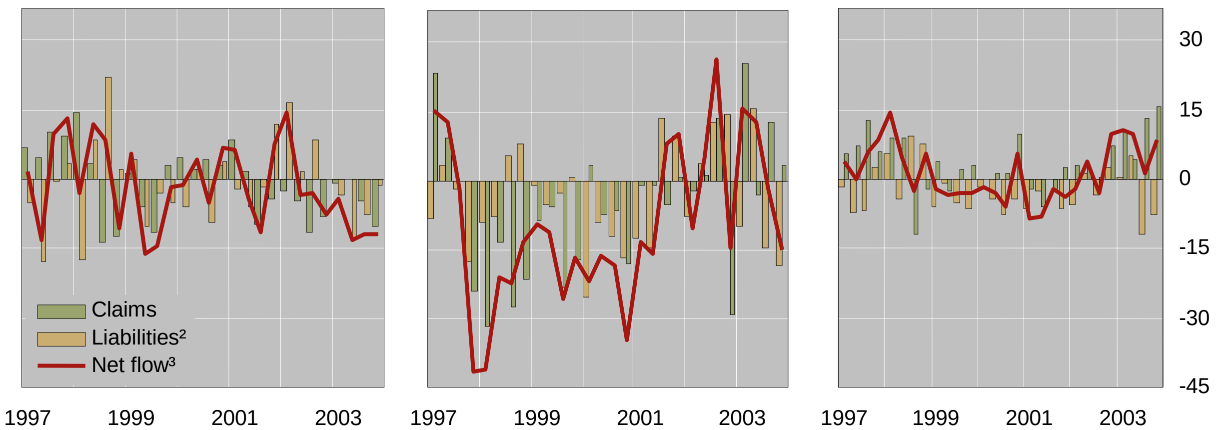
4 The BIS consolidated data, which net out inter-office claims, indicate that total international claims on offshore centres reached $851 billion in the fourth quarter; 73% of these claims were on non-bank private sector borrowers.

5 In addition, $42 billion in foreign currency denominated claims flowed to residents in individual reporting countries. Banks in the United Kingdom extended $26 billion in loans to non-bank residents, while banks in offshore centres channelled $7 billion to residents.

6 Securities issued by residents of Italy and Germany accounted for 39% of all BIS reporting banks' holdings of euro-denominated debt securities. Outstanding debt security claims vis-à-vis Italy and Germany totalled $363 billion and $370 billion respectively, almost double the outstanding stock vis-à-vis France ($182 billion). Debt securities comprised 58% of all euro-denominated claims vis-à-vis Italy, but only 40% of such claims vis-à-vis Germany.

Banking 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

new credit to these borrowers, producing a net outflow of $29 billion (Graph 2.3 and Table 2.2). In Latin America, a 10th consecutive fall in claims, as well as a single large equity transfer, led to a $12 billion outflow from the region. Substantial increases in deposits by banks in Asia-Pacific and the Middle East and Africa drove net outflows. By contrast, greater lending to almost every country in emerging Europe brought about a net inflow into the area.

Claims on emerging markets stabilise

Emerging market loan portfolio moves into safer credits ...

While arguably less prominent than in previous quarters, several trends suggestive of reduced exposure of BIS reporting banks to riskier assets continued in the fourth. These developments took place against a backdrop of robust debt issuance by emerging market borrowers and falling spreads on emerging market debt. After trending downwards over the past year, the overall share of bank claims on emerging markets remained stable for the second consecutive quarter, even as these claims shifted towards regions with higher average credit ratings. Reporting banks' emerging market portfolios moved away from Latin America in relative terms for the fourth consecutive quarter and towards emerging Europe and Asia-Pacific.

... as claims shift out of Latin America ...

An improvement in the average rating of banks' emerging market portfolios, while partially the result of higher sovereign ratings, reflected reduced exposure to riskier credits (Graph 2.4, left-hand panel).[7] Claims on Latin America, which have an estimated (claim-weighted) average rating near the Standard & Poor's B rating, fell to 26.5% of total claims on emerging

[7] The sovereign debt ratings of Indonesia, Malaysia, Thailand and Turkey were upgraded by Standard & Poor's in October 2003. See the Overview in the March 2004 *BIS Quarterly Review* for discussion.

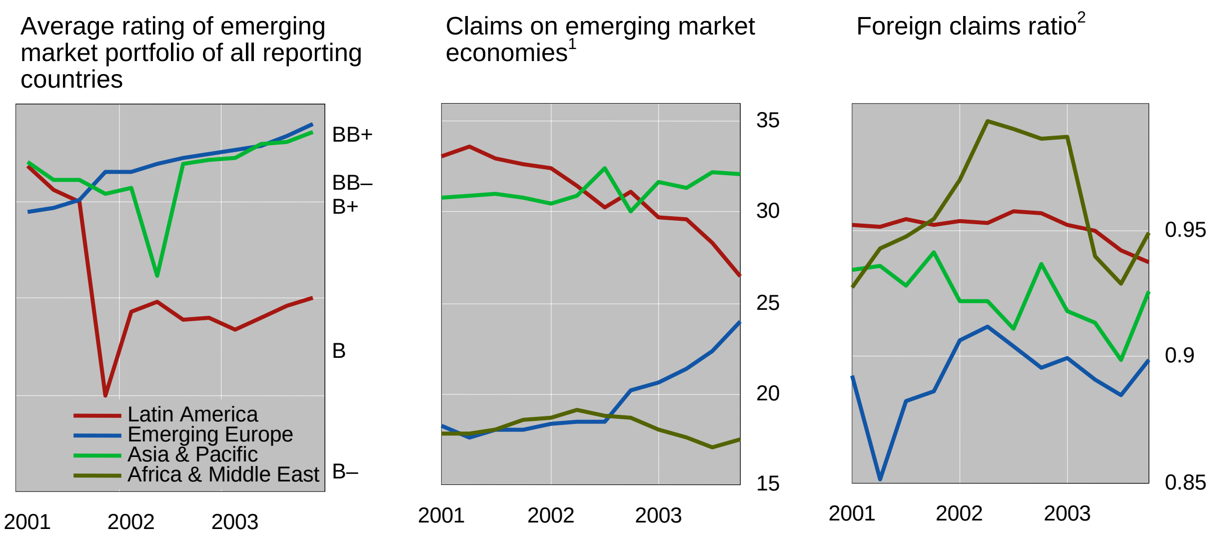
markets, from 28% in the previous quarter and 31% in late 2002 (Graph 2.4, centre panel).[8] Over this same period, the share for emerging Europe, with an average rating near the Standard & Poor's BB+ rating, rose to 24% from 22% in the previous quarter. The share for Asia-Pacific remained stable at 32%.

... and towards the public sector

Although the sectoral distribution of claims on emerging markets was, on the whole, little changed from the previous quarter, claims on several emerging market regions (Latin America and the Middle East and Africa) continued to shift towards the public sector. The BIS consolidated statistics indicate that the share of claims on the public sector in Latin America reached 21% of total international claims on the region, the third consecutive quarterly increase. The corresponding share vis-à-vis this sector in the Middle East and Africa rose to 19% from 17% in the previous quarter and 14% a year earlier.

The share of ultimate risk claims in total foreign claims, a measure of the true exposure of BIS reporting banks, increased in several emerging market regions after three consecutive quarterly declines (Graph 2.4, right-hand panel). In total claims on emerging markets, this share rose from 91% in the previous quarter to 93% in the fourth, primarily reflecting movements vis-à-vis Asia-Pacific and emerging Europe. In particular, net risk transfers out of Korea and China fell, pushing total net risk transfers out of the region down to $35 billion from $45 billion in the previous quarter.[9] In emerging Europe,

Emerging market asset portfolios of BIS reporting banks



[1] Share of total claims on emerging markets. [2] Ratio of foreign claims vis-à-vis emerging economies on an ultimate risk basis to those on an immediate borrower basis.

Graph 2.4

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[8] The average rating of the emerging market portfolio is calculated as the weighted average of the Standard & Poor's sovereign ratings of all vis-à-vis countries to which banks in the reporting area lend. The weights are the share of ultimate risk claims on each vis-à-vis country in total ultimate risk claims. See the September 2003 issue of the *BIS Quarterly Review* for details of the calculation.

[9] Other borrowing countries in the region, namely India, Taiwan (China), Thailand and the Philippines, experienced similar although smaller moves.

Cross-border bank flows to emerging economies

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

	Banks' positions[1]	2002	2003	2002	2003				Stocks at end-Dec 2003
		Year	Year	Q4	Q1	Q2	Q3	Q4	
Total[2]	Claims	–36.9	64.0	–37.0	33.0	–4.2	20.2	14.9	1,006.7
	Liabilities	–45.9	71.9	–11.0	11.0	–10.3	27.7	43.5	1,225.7
Argentina	Claims	–11.8	–8.5	–2.3	–1.9	0.9	–5.4	–2.1	23.4
	Liabilities	0.0	–0.9	0.2	0.5	0.1	–2.2	0.7	24.9
Brazil	Claims	–11.2	–7.2	–6.3	2.2	–1.7	1.4	–9.1	83.1
	Liabilities	–8.0	14.4	–4.3	3.3	6.6	7.9	–3.4	57.1
China	Claims	–12.4	13.5	–10.2	16.0	–6.4	4.9	–1.0	61.1
	Liabilities	–3.6	–6.4	–1.9	1.4	–11.3	1.8	1.8	89.4
Czech Rep	Claims	2.3	3.7	0.3	0.7	0.5	0.8	1.7	19.4
	Liabilities	–3.7	–2.4	–2.7	–1.8	0.1	0.2	–0.9	10.1
Indonesia	Claims	–6.0	–4.7	–1.2	–1.1	–1.0	–1.9	–0.8	29.0
	Liabilities	–2.4	0.2	–0.5	0.4	–0.1	–0.5	0.3	12.5
Korea	Claims	8.2	–1.1	–6.4	2.3	–2.0	–1.8	0.3	76.5
	Liabilities	0.5	7.3	–4.8	–0.8	–6.1	1.6	12.6	40.0
Mexico	Claims	3.1	–0.8	0.0	–0.5	–0.1	0.8	–0.9	65.4
	Liabilities	–11.4	6.2	1.7	4.5	2.2	–0.3	–0.1	62.2
Poland	Claims	2.9	3.3	–0.4	0.9	0.9	1.0	0.4	33.2
	Liabilities	–3.1	–0.1	–2.5	0.8	–1.1	–1.0	1.2	18.7
Russia	Claims	3.6	12.1	2.4	1.8	1.7	2.8	5.8	49.1
	Liabilities	9.6	16.2	2.0	5.6	–4.4	7.2	7.8	57.7
South Africa	Claims	–0.4	–1.2	1.5	–0.4	0.8	–0.9	–0.7	18.5
	Liabilities	2.7	9.7	1.4	0.6	4.8	1.4	2.8	32.1
Thailand	Claims	–5.0	–1.6	–1.8	–0.3	0.3	0.0	–1.6	18.8
	Liabilities	–4.6	5.7	–1.2	2.5	–0.9	0.9	3.2	17.8
Turkey	Claims	–2.8	5.3	–0.1	2.4	–0.5	3.4	0.1	44.4
	Liabilities	0.0	–0.4	0.5	–3.9	1.5	1.0	0.9	20.5
Memo:									
EU accession countries[3]	*Claims*	*10.1*	*21.8*	*3.3*	*5.7*	*1.4*	*5.7*	*9.1*	*126.8*
	Liabilities	*–6.4*	*–0.8*	*–5.4*	*–2.1*	*–1.2*	*2.0*	*0.5*	*66.9*
OPEC members	*Claims*	*–9.8*	*–6.7*	*–8.2*	*–0.3*	*–6.4*	*–1.9*	*1.9*	*130.1*
	Liabilities	*–8.8*	*–15.1*	*1.5*	*–5.2*	*–11.8*	*–10.2*	*12.2*	*251.4*

[1] External on-balance sheet positions of banks in the BIS reporting area. Liabilities mainly comprise deposits. An increase in claims represents an inflow to 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] Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

Table 2.2

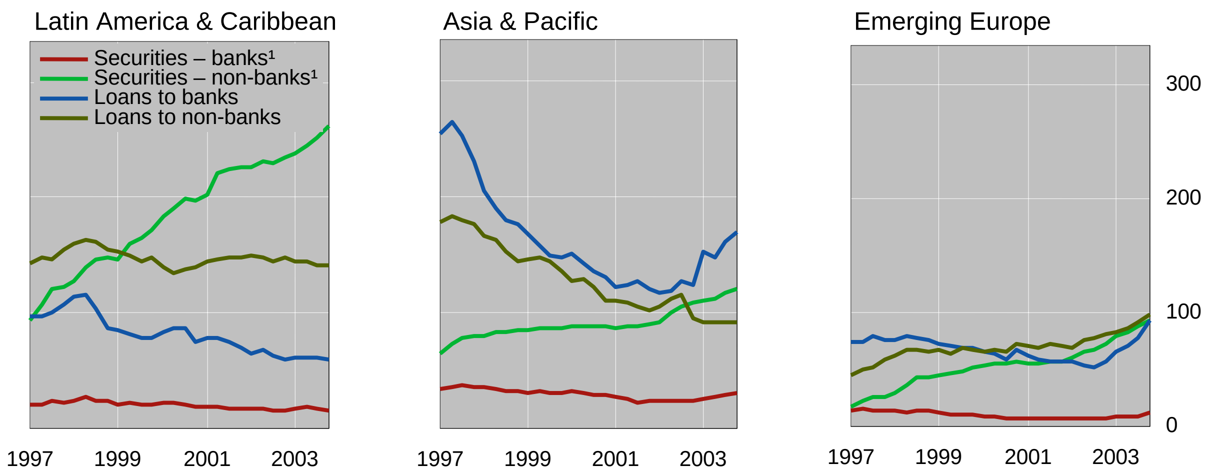
increased local currency lending to the Czech Republic contributed to a rise in the ratio for the region as a whole; the share of ultimate risk to immediate borrower claims grew to 90% after falling to 88.5% over the previous two quarters.

Emerging market borrowers increasingly turn to bond financing over loans

Overall, emerging market borrowers have increasingly turned to bond financing in preference to bank loans. Their robust issuance of debt securities, and the compression in spreads on this type of debt, in the course of the last

International credit to emerging economies

Amounts outstanding, in billions of US dollars



[1] Long-term bonds, notes and short-term money market instruments issued in international markets.

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Graph 2.5

year suggest that international bond investors were rather sanguine about emerging market risk throughout 2003. As shown in Graph 2.5, which combines the BIS international banking data with data on outstanding debt securities, emerging market borrowers, particularly non-banks, have increasingly turned to debt issuance over loans. This is particularly true in Latin America and Asia-Pacific, regions at opposite ends of the rating spectrum. The outstanding stock of loans to non-bank borrowers in Latin America has fallen to 35% of total international credit to non-banks in the region, from 39% at end-2002 and 56% at end-1997. A similar shift has been evident in Asia-Pacific (see box on page 23).

Net outflow from Latin America for the seventh quarter in a row

Outflow from Latin America reflects reduced loans ...

Reduced lending to all sectors in Latin America led to the seventh consecutive quarterly outflow of funds from the region. The fourth quarter saw a $12 billion outflow, although this was largely the result of a single bilateral move vis-à-vis banks in Brazil. Excluding this, net claims fell by $6 billion. A relatively steep drop in claims on the region (the 10th consecutive quarterly decline) pushed the year-over-year rate of contraction in claims to 6% from 5% in the previous quarter. At the same time, liabilities to Latin America remained stable overall, although deposit repatriations by residents of Brazil were noteworthy.

... and reduced equity claims on banks in Brazil

Movements vis-à-vis Brazil accounted for almost half of the large net outflow from the region as a whole. However, unlike in the previous two quarters, when significant increases in deposits placed with BIS reporting banks were the primary factor, the most recent outflow was the outcome of a sizeable equity transfer. A bank in Spain transferred its equity holdings in a bank in Brazil to a non-bank holding company (and thus out of the BIS reporting population). Consequently, total claims of banks in Spain on the Brazilian banking sector fell by $7.2 billion to $410 million. Excluding this move, the net flow of funds into Brazil, while modest, was positive for the first time in six quarters, as deposit repatriations more than offset reduced loans to the country. Non-bank borrowers in Brazil repatriated $2.5 billion in deposits, primarily from banks in the United States and offshore centres, while banks in the reporting area decreased loans to Brazil's banking sector by $2.3.

A decline in lending to Argentine borrowers also contributed to the net outflow from the region. Loans to non-bank borrowers in Argentina were down for the eighth consecutive quarter, giving rise to a net outflow of $3 billion. While the outstanding stock of loans from banks in the United States contracted the most, that from banks in the euro area also shrank, probably in part the result of the continued write-off of loans to Argentine borrowers. Total claims on Argentina fell to $23 billion, or slightly less than 9% of total claims on the region from 11% a year earlier.

Increased deposits by banks in Korea drive net outflow from Asia-Pacific

Growth in deposits placed with reporting area banks greatly outpaced new lending to Asia-Pacific, yielding the largest net outflow from the region since the second quarter of 2001. Following a substantial rise in deposits by Indian residents in the previous quarter, an even larger one by Korean residents in the fourth drove a net $15 billion in funds from the region. The growth in deposits placed abroad was partially offset by new lending to the region. Increases in loans to borrowers in Taiwan (China)[10] and India offset decreased lending to those in Thailand, Pakistan and China, and pushed total claims on the region to $323 billion.

Banks in Korea deposit funds abroad ...

Korea remains the BIS reporting banks' largest net debtor in Asia-Pacific. Yet, a second consecutive quarter of net outflows seems to have capped the rise in the stock of net claims that started in the second quarter of 2002 (Graph 2.6, left-hand panel). The increase in deposits in the fourth quarter of 2003 may have in part reflected Korea's ongoing accumulation of foreign exchange reserves, as well as surplus liquidity of commercial banks.[11] In the fourth quarter, banks in Korea parked $11 billion in funds as bank deposits in offshore centres and the United Kingdom.

... as do banks in Thailand

Movements vis-à-vis other countries also contributed to the net outflow from the region. As in Korea, banks in Thailand placed surplus funds abroad in a quarter in which foreign exchange reserves continued to grow. They deposited $3 billion (primarily in US dollars, but also in euros) with banks in the United Kingdom, offshore centres and, to a lesser extent, Switzerland and Spain. This pushed total liabilities vis-à-vis Thailand to $17.8 billion, or 5% of total liabilities vis-à-vis the region (from 4% in the previous quarter).

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[10] Hereafter Taiwan.

[11] Foreign exchange reserves rose to $154.5 billion in the fourth quarter of 2003, from $140.8 billion in the third and $130.9 billion in the second. The annual percentage change in total domestic credit in Korea decreased to 9.3% in the fourth quarter of 2003, from 12.4% in the third and 15.8% in the second.

Cross-border holdings of Asian bonds: banks and all investors

Robert N McCauley and Patrick McGuire

While there is broad agreement among policymakers in East Asia that further financial integration in the region would be desirable, no such consensus has emerged regarding the proper understanding of the current extent of such integration. Market-based analysts highlight the importance of the "Asian bid" – that is, a disproportionate representation of regional buyers – in the primary and secondary market for dollar bonds issued by East Asian governments, banks and firms.[①] This view has been challenged, however, by reference to official Japanese data on holdings of bonds by Japanese residents, which suggest low and declining holdings of the obligations of Asian issuers.

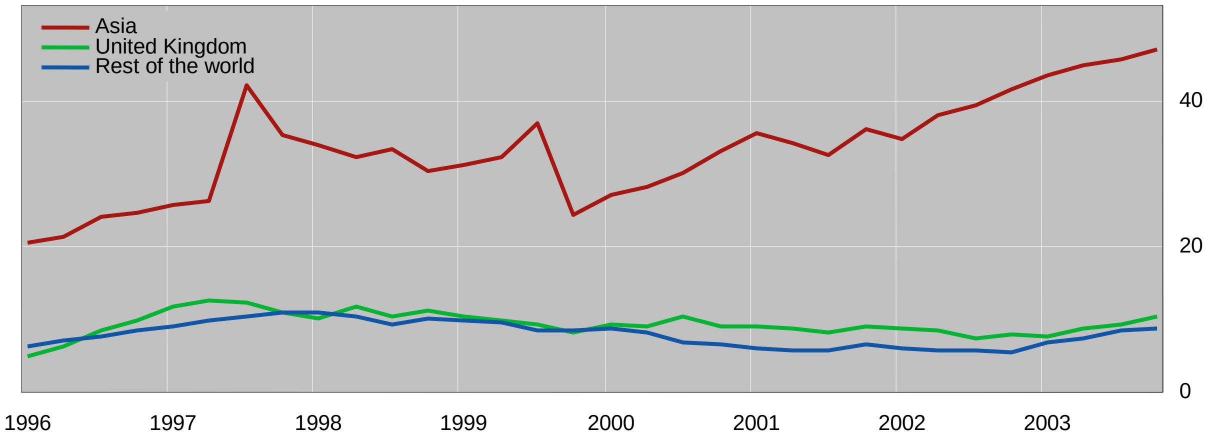
This box consults two sources of evidence to shed light on the extent of the regional bias in holdings of international bonds issued by East Asian borrowers. First, the BIS international banking data report banks' cross-border claims that take the form of bonds, providing country detail and a time series perspective. Banks are natural buyers of bonds, especially those of relatively short maturity or bearing floating interest rates, but represent just one investor segment. Second, the IMF portfolio survey of security holdings provides broader coverage of the investor base, capturing institutional investors as well as banks, but only a snapshot at end-2002. The IMF data are in principle universal, while the BIS reporting area does not include all the important Asian economies.

BIS international banking data

Even as a means to profile a single segment of investor demand, the BIS data are limited by the reporting area, which does not include some important economies in East Asia. In particular, while Hong Kong SAR, Japan and Singapore are long-time reporters, Australia and Taiwan have joined only recently. Yet to participate are China, Korea, Malaysia and Thailand. Thus, Asian holdings of Asian bonds as measured by the BIS data will be smaller than the actual amount insofar as banks in these latter countries hold bonds issued by their neighbours. The data include both international bonds and domestic securities held offshore, for instance a Hong Kong bank's holdings of a Korean treasury bond (which are, judging by Korean flow of funds data, very small).[②]

Estimated holdings of Asian bonds by BIS area banks

In billions of US dollars



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① See F Schmidt, *Asia's credit market: from high-yield to high-grade*, Singapore: Wiley Asia, Chapter 2, 2004.
② The data also include some holdings of short-term paper, such as certificates of deposit, that are not relevant to the question under discussion.

Cross-border investment in bonds, end-2002

In millions of US dollars

Invested in:	Investment from: HK	ID	JP	KR	MO	MY	PH	SG	TH	Total from Asia	Total in Asia	Asia share[1]
China	1,232	...	578	38	15	...	2	416	–	2,281	3,430	67
Hong Kong SAR	...	57	1,137	455	521	40	58	1,653	20	3,941	7,208	55
India	...	...	159	47	8	1	...	241	–	456	788	58
Indonesia	...	...	49	78	...	1	4	869	–	1,001	2,462	41
Japan	5,351	...	–	29	21	...	5	3,828	–	9,234	159,937	6
Korea	4,202	...	5,348	...	23	51	15	2,586	–	12,225	25,015	49
Macao SAR	...	...	–	...	...	...	...	...	–	0	1	0
Malaysia	2,085	3	1,823	332	3	...	9	1,830	–	6,085	8,844	69
Philippines	...	5	1,389	81	...	4	...	595	–	2,074	7,805	27
Singapore	1,842	23	680	144	31	41	23	...	–	2,784	6,451	43
Taiwan, China	674	...	46	...	13	...	7	333	–	1,073	1,372	78
Thailand	447	...	550	24	...	1	...	542	–	1,564	1,895	83
Total in Asia	15,833	88	11,759	1,228	635	139	123	12,893	20	42,718	225,208	19
Total investment	123,528	703	1,135,519	9,608	2,637	471	1,553	52,830	1,344	1,328,193	7,733,214	17
Asia share[1]	12.8	12.5	1.0	12.8	24.1	29.5	7.9	24.4	1.5	3.2	2.9	.
Share of inv in Asia[1]	7.0	0.0	5.2	0.5	0.3	0.1	0.1	5.7	0.0	19.0	.	.
Share of inv in Asia excl JP[1]	16.1	0.1	18.0	1.8	0.9	0.2	0.2	13.9	0.0	51.3	.	.

[1] In per cent.

Source: IMF.

The BIS banking data do suggest a regional bias in holdings of Asian bonds by Asian banks. This conclusion emerges from two findings. First, as of the fourth quarter of 2003 BIS area banks held an estimated $66 billion in bonds issued by borrowers from Asia excluding Japan.[3] In terms of country composition, the largest holdings are vis-à-vis Singapore and Korea (as suggested by the BIS data on international bonds issued by Asia excluding Japan). Second, an estimated two thirds of these bonds are held in Asia, including Hong Kong, Japan, Singapore and Taiwan (see the graph on the previous page). About half the rest are held by banks in the United Kingdom.[4] Holdings of Asian bonds by reporting banks in Asia were squeezed by the combination of regional banks' loss of access to international interbank markets during the period of the Japan premium and the Asian crisis, but have risen since mid-1999.

[3] Asia excluding Japan includes Hong Kong SAR, Macao SAR and Singapore, countries typically classified as offshore centres in the BIS international banking data. [4] The country composition of the international bond holdings reported by banks in Hong Kong is estimated using the country composition of loans, and bond holdings are estimated for Japan and Singapore from country by country data on non-loan claims.

IMF portfolio survey

The IMF survey of cross-border portfolio holdings of bonds provides a matrix of holdings for East Asia and allows these holdings to be put into a global context. It shows holdings of long-term debt securities at the end of 2002 and includes both foreign currency and local currency bonds. These data need to be interpreted with some care because the decomposition by country is often not complete.

The data indicate an uneven but in aggregate a high degree of regional bias in bond holdings across Asia excluding Japan. Asia excluding Japan holds over half (51.3%) the bonds issued by borrowers in that area (last row of the table). In the first column of the table, for instance, investors in Hong Kong put 12.8% of their international bond portfolio into Asian bonds, and, given the size of their aggregate portfolio, they account for a high share (7%) of international holdings of such bonds. Excluding Japanese bonds, Hong Kong holds 16% of global holdings of Asian bonds. Singapore puts a higher fraction of its overall international bond portfolio in Asian bonds, but, given its portfolio size, accounts for a smaller share (13.9%) of global holdings of Asia excluding Japan's bonds. These portfolio data support the hypothesis of a regional bias.

It turns out that the largest foreign investor in the region, Japan, does not show an Asian bias. While Japan's holdings of Asian bonds amount to more than Hong Kong's or Singapore's holdings (last row of the table), they are very small from the Japanese perspective. Of the grand total of $7.7 trillion in cross-border bond investment captured by the survey, Asian bonds amount to about $225 billion (about 3%), of which Japanese bonds account for around two thirds ($160 billion). Global holdings of bonds from Asia excluding Japan thus amount to approximately 1% of holdings. Japan's holdings of bonds from Asia excluding Japan are also around 1%, which is about par. Despite the scale of the Japanese portfolio and proximity, therefore, Japan has no disproportionate holdings of Asian bonds. In contrast, with double digit percentage weights on Asian bonds, investors in Hong Kong, Indonesia, Korea, Macao (where the currency board vis-à-vis the Hong Kong dollar must play a role), Malaysia and Singapore do favour regional bonds. Given the scale of holdings, the regional bias derives mostly from the behaviour of portfolio managers in Hong Kong and Singapore. The result of a neutral Japanese weight, on the one hand, and regional bias elsewhere in the region, on the other hand, are the high fractions of internationally held bonds of Asia excluding Japan to be found in Asia (last column of the table).

It can still be asked: who are the beneficial owners of the bonds held in the financial centres of Hong Kong and Singapore? To the extent that they are held at branches of banks headquartered outside the region, one could question whether there really is a regional bias. Whether institutional investors like insurance companies and pension funds would hold bonds in these centres to fund liabilities to retirees and policyholders outside the region is another issue.

Based on the data reviewed, it can be said that a disproportionate share of cross-border holdings of bonds issued by East Asian borrowers are held in bank and institutional portfolios located in East Asia. Whether the ultimate beneficial ownership of these securities, in some sense, is likewise concentrated in Asia remains an open question.

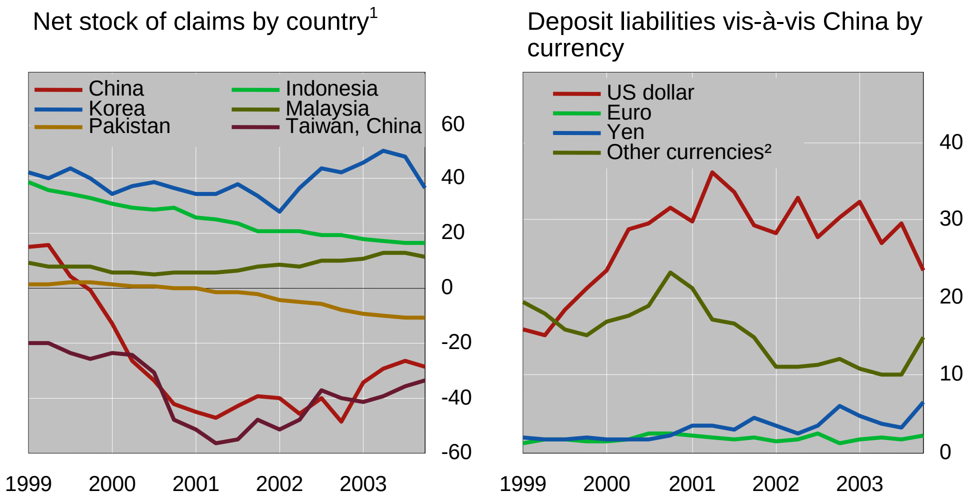
A similar expansion of deposits by non-bank residents in China, coupled with a contraction in lending to these borrowers from banks abroad, was behind the $3 billion net outflow from the country. Non-banks in China withdrew a total of $0.9 billion in US dollar deposits from banks in the United Kingdom, and at the same time increased local currency deposits in banks in Hong Kong SAR by $3 billion.

Banks in China shift deposits placed abroad out of US dollars

While the deposits of banks in China placed abroad were little changed from the third quarter, a significant shift in the currency composition of these deposits was evident (Graph 2.6, right-hand panel). The Chinese banking system as a whole transferred roughly 7% of its total US dollar deposits into other (primarily Asian) currencies during a quarter in which the US dollar depreciated against both the yen and other major currencies. Banks in China

Positions of BIS reporting banks vis-à-vis Asia-Pacific

In billions of US dollars



[1] Claims minus liabilities. [2] Domestic currency deposit liabilities of offshore centres. Graph 2.6

repatriated $5 billion in US dollar deposits from banks in the United States, and an additional $2.6 billion from banks in offshore centres. At the same time, their yen-denominated deposits in banks in Japan and local currency deposits in banks in Hong Kong grew by similar amounts.

Increase in claims on emerging Europe sets second consecutive record

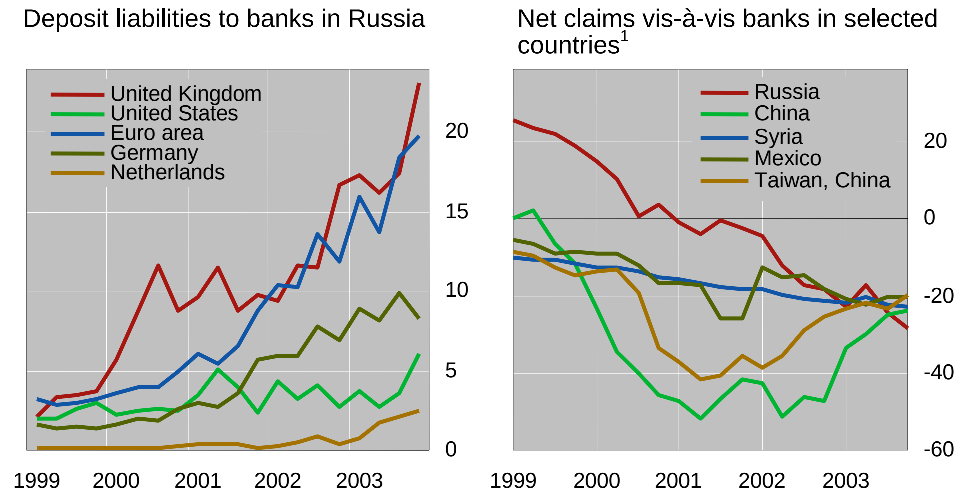
A record increase in claims on emerging Europe ...

As in the previous quarter, increased claims overshadowed a rise in deposits placed abroad to produce a fifth consecutive net inflow into emerging Europe in the fourth quarter of 2003. Moreover, the growth in claims on the region as a whole, at $16 billion, was the largest in the BIS coverage period, surpassing the previous record in the third quarter ($13 billion). As a result, claims on emerging Europe rose to 24% of total claims on emerging markets, up from 22% in the previous quarter and 20% a year earlier. Nine billion dollars of the overall expansion in claims on the region flowed to the EU accession countries, particularly to banks in Hungary, the Czech Republic, Malta and Slovakia. New lending to banks in Russia made up much of the difference. Liabilities vis-à-vis the region were also up, by $7.4 billion, following an even larger rise in the previous quarter. Again, this reflected increased deposits by banks in Russia with BIS reporting banks.

Unlike in the previous quarter, when investment in government securities was an important factor, the expansion in claims on the region in the fourth quarter was mainly the outcome of new lending to banks. Total claims on this sector rose by $13 billion, as banks in the reporting area, primarily in Austria, the United Kingdom, Germany and Luxembourg, extended a combined $9.4 billion in new loans to banks in the region, mainly those in Russia, Malta, the Czech Republic and Poland. Banks in Austria also channelled an additional $1 billion to this sector through purchases of debt securities issued by banks in Hungary, Russia and elsewhere.

Cross-border positions vis-à-vis emerging economies

In billions of US dollars



[1] Claims minus liabilities.

Graph 2.7

... and deposits placed abroad by Russian banks drive net inflow

Banks in Russia deposited substantial sums abroad for the second consecutive quarter, concurrent with an increase in foreign exchange reserves held by the Russian central bank (Graph 2.7).[12] As a result, total liabilities vis-à-vis all sectors in Russia stood at $57.7 billion, making Russia the fourth largest gross creditor to the international banking system among emerging markets (behind China, Taiwan and Mexico). On a net basis, the expansion in deposits by Russia's banking sector in the second half of 2003, combined with the repatriation of deposits over the past year by banks in China, has made the Russian banking system the largest contributor of funds among banking systems in emerging markets; Russia's banking sector provides a net $28 billion to BIS reporting banks, compared with China's $24 billion and Syria's $23 billion.[13] In the most recent move, banks in Russia increased US dollar deposits in the United Kingdom and the United States by $4.5 billion and $2.7 billion respectively, and euro-denominated deposits in France by $2 billion.

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[12] After a slight decline in the third quarter of 2003, foreign exchange reserves held by the Central Bank of the Russian Federation (which include reserves held by the Russian finance ministry) rose from $58.3 billion to $73.2 billion in the fourth quarter.

[13] Across all sectors, residents of Russia provide a net $8.5 billion to BIS reporting banks.

International syndicated credits in the first quarter of 2004

Blaise Gadanecz and Jesper Wormstrup

Activity in the international syndicated loan market in the first (and traditionally weak) quarter continued to be driven by the energy sector. Signings totalled $244 billion, which on a seasonally adjusted basis constitutes an unchanged volume compared with the previous quarter.

US borrowers generated business in line with their historical average. Their signings came to $132 billion, or 54% of global international activity. Companies from the energy and electricity sectors continued to be most active, closing deals totalling $23 billion. Exxon Mobil Corp signed a $5.4 billion revolving credit line, the largest individual deal in the first quarter. Over recent quarters, there has been a decline in the average spreads on loans priced off the US prime rate granted to US borrowers, together with a lengthening of average loan maturities. These developments are consistent with recent evidence that banks were easing lending standards in the first quarter on US commercial and industrial loans.[①]

Lending to western European entities increased modestly from a year ago. Deals worth $69 billion were arranged, with refinancings accounting for 47%, a low percentage by historical standards. Lending for M&A purposes represented 23% of the total, in line with past trends.[②] Retailers and water purification companies, together with the hotel industry, received the most significant amounts.

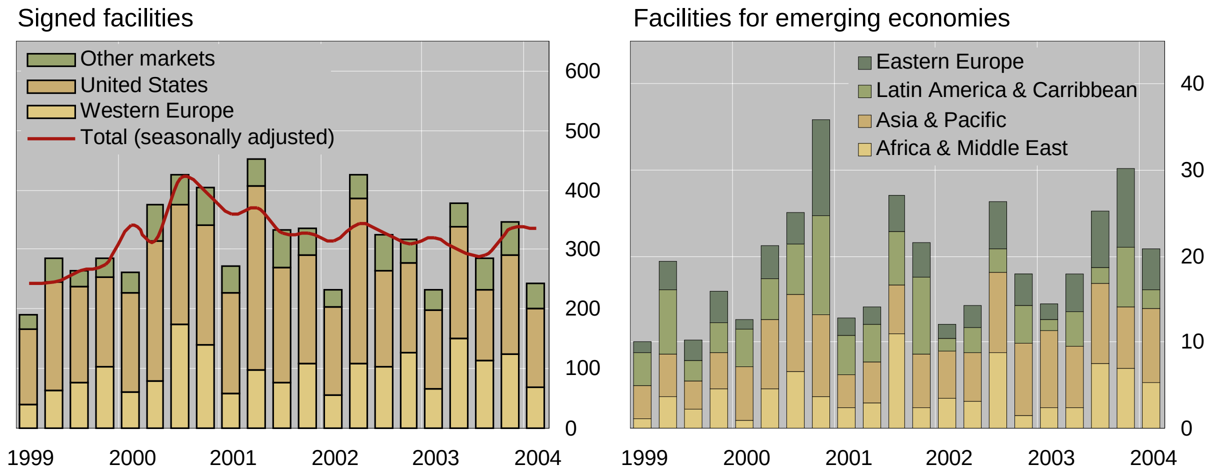
Borrowing by emerging market entities was exceptionally strong, with signings reaching their highest level in any first quarter since 1997. In a total of $21 billion, Asian borrowers secured the largest amount ($8.6 billion), boosted by substantial deals in the electronics and telecommunications industries in both China and Taiwan. A project finance deal, worth $1 billion, to fund the construction of an oil pipeline between Azerbaijan and Turkey by an international consortium was the first signing by an entity registered in Azerbaijan in five years.

In anticipation of EU membership, entities from accession countries drove borrowing in emerging Europe to the highest level of any first quarter. Large amounts were secured by Polish oil companies and the Hungarian government, which arranged a sovereign standby facility of €500 million for debt and liquidity management purposes. In the past few years, commercial banks, telecommunications firms and oil and energy companies have typically taken on the lion's share of international syndicated lending to accession countries.

Borrowing by Mexican and Chilean energy and transportation companies accounted for a major part of Latin American activity. Business in the Africa and Middle East region was relatively strong, with signings worth a total of $5.3 billion. The National Iranian Oil Company arranged a facility of $1.7 billion for trade financing purposes, the largest signing by an emerging market entity in the first quarter of 2004.

Activity in the international syndicated credit market

In billions of US dollars



Sources: Dealogic Loanware; BIS.

① See Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, April 2004. ② Not included in the data compiled by the BIS is the €16 billion facility arranged for Sanofi-Synthélabo SA to support its acquisition of Aventis. The loan was funded but not signed in the first quarter.