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2. The international banking market

Cross-border activity surged in the first quarter of 2004. US dollar-denominated interbank claims, much of them involving repo transactions, drove the increase. Euro-denominated claims were up too. Although overshadowed by interbank activity, new credit to non-bank borrowers was also robust. Notably, this credit seemed to reflect a pickup in lending to offshore and other major financial centres, as well as purchases of government and other international debt securities, rather than renewed corporate loan demand.

A record expansion in deposits placed with BIS reporting banks outpaced a rise in lending to emerging markets, resulting in an overall net outflow from these economies. The growth in deposits to some extent reflected the placement with BIS reporting banks of foreign exchange reserves held by monetary authorities in emerging markets. Among different regions, increased deposits in BIS reporting 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.

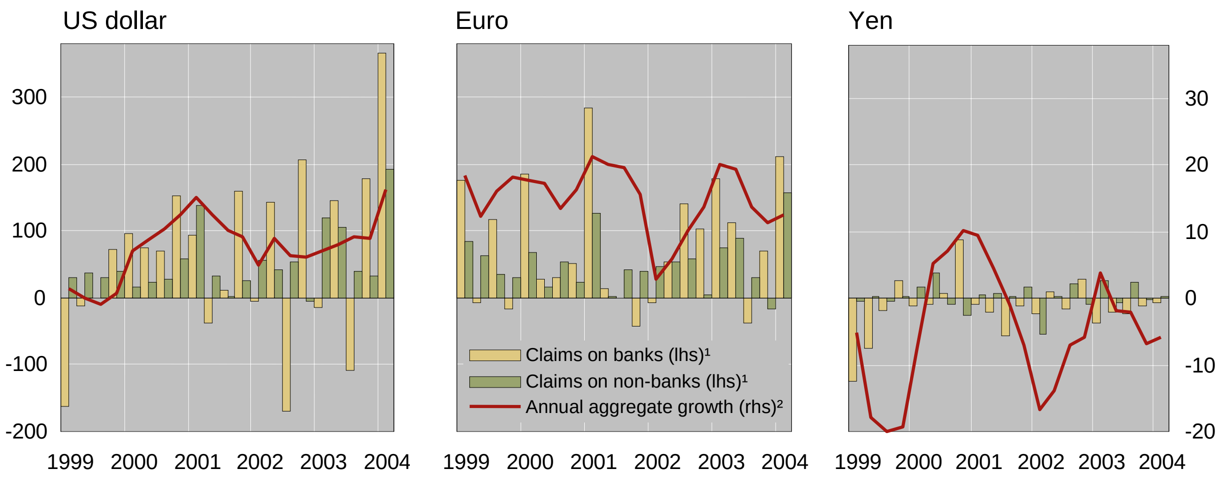
Record increase in claims fuelled by interbank activity

A record surge in total claims in the first quarter of 2004 was fuelled by US dollar- and euro-denominated interbank business (Graph 2.1). Total interbank claims of BIS reporting banks rose by $778 billion, by far the largest quarterly increase in the BIS coverage period. New credit to non-bank borrowers also rose by a record amount ($403 billion), driving total claims up by 7.5% from the previous quarter to $17.2 trillion. This pickup in credit to non-bank borrowers, while large, did not seem to indicate new lending to non-financial corporates. Rather, the flow was primarily to borrowers in the United Kingdom, offshore centres and other major financial centres, areas with a high concentration of non-bank financial activity.

Banks send dollars to London for distribution to borrowers elsewhere

Fuelled by a pickup in repurchase agreements, interbank claims soared in the first quarter of 2004. The $778 billion increase, almost double the previous record rise, was driven by US dollar-denominated interbank activity, although euro-denominated interbank claims expanded noticeably as well. Globally, Swiss, French, US, German and UK banks poured funds into the interbank

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

market. While virtually all of Swiss banks' activity was accounted for by inter-office transfers ($144 billion of a $146 billion increase), less than half of the overall rise in the interbank lending of French, US and UK banks reflected inter-office claims.[1]

Banks channel US dollars to London ...

Banks deposited substantial US dollar-denominated funds in the United Kingdom, driving London banks' largest net inflow of US dollars in the BIS reporting period. Deposits from banks in offshore centres, the United States and the euro area contributed to a $136 billion increase in interbank liabilities of banks in London, primarily German-, Swiss- and UK-headquartered banks located there. However, despite relatively robust interbank lending out of the United Kingdom, less than two thirds of the deposited funds were redirected back into the interbank market. This yielded a $69 billion net inflow of US dollars to banks in the United Kingdom.

... for distribution to borrowers elsewhere

These funds were used to finance US dollar lending to non-bank borrowers. Indeed, this sectoral transformation, by which US dollar funds from the London interbank market are used to finance US dollar borrowing by non-banks, has become more apparent since the late 1990s (see the special feature on London's interbank market on page 67. In the most recent quarter under review, banks in London channelled US dollars from the interbank market to non-bank borrowers resident in the United Kingdom ($30 billion in net funds), the United States (a net $22 billion) and offshore centres (a net $12 billion).

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[1] Only $42 billion of French banks' $124 billion increase in interbank claims resulted from inter-office activity. The corresponding figure for US banks was $50 billion of a $119 billion increase, and that for UK banks was $56 billion of $113 billion. None of the interbank lending of German banks reflected inter-office activity (–$8 billion of $116 billion).

Loans flow to non-bank borrowers in major financial centres

More generally, the growth in credit to non-bank borrowers in the first quarter of 2004 seemed to reflect new lending to offshore centres and other financial centres, as well as investment in debt securities. Total claims on non-banks were up by a record $403 billion; the increase in US dollar-denominated credit ($193 billion) was driven by new loans and that in euro-denominated credit ($157 billion) reflected investment in euro area debt securities.

Credit to non-banks is driven by loans to offshore centres ...

While new loans to non-bank borrowers were strong by the standards of recent quarters, this is unlikely to have reflected a pickup in corporate loan demand. Nearly one quarter of the increase in US dollar-denominated loans to non-banks, and nearly two thirds of euro-denominated loans, flowed to non-bank borrowers in offshore centres, Luxembourg and the United Kingdom, areas with considerable non-bank financial activity. For instance, the BIS consolidated statistics, which track the global operations of banks headquartered in a particular country, indicate that roughly 90% of the expansion in German banks' claims on the non-bank private sector flowed to borrowers in these areas. The corresponding figures for Belgian and Dutch

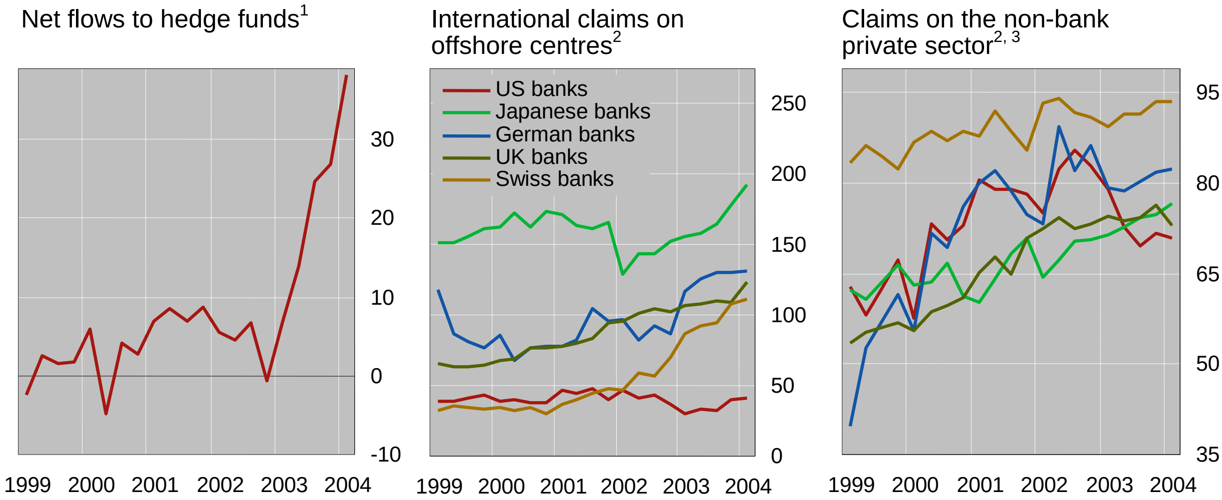
Cross-border claims of BIS reporting banks

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

	2002	2003	2003				2004	Stocks at end-Mar 2004
	Year	Year	Q1	Q2	Q3	Q4	Q1	
Total cross-border claims	740.1	1,076.6	376.8	493.8	–110.0	315.9	1,180.8	17,185.2
on banks	425.0	531.0	175.6	307.9	–229.5	277.1	777.9	11,084.2
on non-banks	315.2	545.5	201.2	185.9	119.5	38.9	402.9	6,101.0
Loans: banks	392.9	453.2	142.1	325.6	–262.5	248.1	701.7	9,449.0
non-banks	103.8	277.4	142.0	24.3	91.4	19.6	213.5	3,225.4
Securities: banks	36.3	75.4	26.2	–8.2	21.1	36.3	64.0	1,154.5
non-banks	202.2	208.2	70.4	123.4	9.2	5.3	169.6	2,555.3
Total claims by currency								
US dollar	320.4	500.3	105.3	252.4	–68.3	210.9	559.2	6,881.7
Euro	453.3	503.0	254.4	202.6	–7.9	53.9	371.2	6,333.8
Yen	–42.3	–50.4	–10.9	–25.4	0.7	–14.8	–3.2	785.2
Other currencies[2]	8.7	123.7	28.0	64.2	–34.5	65.9	253.6	3,184.5
By residency of non-bank borrower								
Advanced economies	315.1	459.3	148.8	159.9	103.3	47.3	339.6	4,807.5
Euro area	117.4	157.5	57.2	67.5	50.5	–17.7	149.9	2,151.6
Japan	4.1	38.4	21.5	15.6	6.5	–5.2	–0.3	184.8
United States	153.1	179.9	25.8	60.0	40.9	53.3	101.3	1,621.4
Offshore centres	18.8	99.8	80.9	18.9	10.2	–10.2	42.7	672.2
Emerging economies	–16.5	5.1	–6.2	3.3	4.9	3.1	25.1	572.7
Unallocated[3]	–2.2	–18.7	–22.3	3.8	1.1	–1.3	–4.5	48.6
Memo: Local claims[4]	*44.5*	*415.2*	*180.6*	*88.8*	*51.7*	*94.1*	*194.2*	*2,534.1*

[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

Inflows to hedge funds and claims on offshore centres



[1] In billions of US dollars. [2] BIS consolidated banking statistics, amounts outstanding in billions of US dollars. [3] As a percentage of total international claims.

Sources: TASS Research; BIS. Graph 2.2

banks, which channelled fairly substantial funds to this sector, were 75% and 48% respectively. This occurred in a quarter in which hedge funds enjoyed a record net inflow of funds (Graph 2.2).

... and borrowers in the United States

US dollar-denominated claims on non-bank borrowers outside these areas also rose noticeably, the result of new credit from banks in offshore and other major financial centres. In particular, over half of the increase in total US dollar-denominated loan activity was accounted for by $83 billion in new loans to non-bank borrowers in the United States. Three quarters of these loans came from banks in the United Kingdom, and much of the rest from banks in offshore centres, suggesting the funding of securities houses. While the pickup in loans could indicate renewed corporate loan demand, evidence from the US flow of funds data and the bond markets suggests otherwise. Total bank credit in the United States rose by $905 billion in the first quarter, but was driven by investment in agency securities and mortgage lending rather than lending to corporates. Moreover, the growth in corporate earnings in the United States, and prefunding by some firms in 2003, led to sluggish bond issuance in the first quarter of 2004, indicating weak corporate demand for funds.[2]

While US dollar-denominated loan activity drove overall claims on non-bank borrowers, investment in euro-dominated international debt securities was strong as well. Two thirds of the $157 billion increase in euro-denominated claims took the form of international debt security claims, over half of which

[2] Total bond issuance by non-financial corporations was down by roughly 5% over the first four months of 2004 compared to the same period in the previous year. See the Overview of the June 2004 *BIS Quarterly Review*.

were vis-à-vis Germany, Italy and France, countries which issued significant amounts of government debt in the first quarter of 2004.[3]

Deposits stoked by growth in foreign exchange reserves

A substantial increase in deposits placed with BIS reporting banks led to net outflows from developing countries for the third consecutive quarter. In the first quarter of 2004, banks in emerging markets, primarily those in Asia-Pacific and the Middle East and Africa, deposited a record $97 billion with BIS reporting banks. Credit to all sectors in emerging markets was overshadowed by the increase, yielding a net outflow of $34 billion, the largest since the first quarter of 2001.

A rise in deposits from emerging markets ...

The robust growth in deposits seemed to at least partially reflect the accumulation and management of reserves by monetary authorities in emerging economies. Deposit liabilities of BIS reporting banks to official monetary institutions (worldwide) grew by $58.5 billion in the first three months of 2004, the largest quarterly rise since late 1999. This occurred during a quarter in which foreign exchange reserves deposited with commercial banks by official monetary authorities in many *developed* countries decreased, suggesting that much of the growth observed in the BIS data was due to monetary authorities in emerging markets. Indeed, deposit liabilities to these monetary authorities accounted for an estimated two thirds, or $424 billion, of the total stock of deposit liabilities of BIS reporting banks to official monetary authorities.[4]

... coincides with an increase in FX reserves

Although data on reserves held as deposits are not available for most countries (see box on page 18), Graph 2.3 shows that the rise in *total* (across region) foreign exchange reserves observable since 2002 has coincided with an equally sharp rise in the stock of liabilities vis-à-vis banks in each region. Presumably, this reflects the placement of (a portion of) these foreign exchange reserves with BIS reporting banks.[5] In the most recent quarter under review, total foreign exchange reserves of emerging markets grew by

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[3] Net issuance of international debt securities (all currencies) by euro area governments hit a record $76.4 billion in the first quarter of 2004. Germany, France and Italy accounted for half of this. See the international debt securities chapter of the June 2004 *BIS Quarterly Review* for a discussion.

[4] Data on the BIS reporting banks' positions vis-à-vis official monetary authorities are available only on an aggregate basis (ie no vis-à-vis country breakdown). Thus, the estimate for total deposits with BIS reporting banks from emerging market monetary authorities is calculated as a residual. The foreign exchange reserves held as bank deposits for developed countries (from the IMF SDDS data) and the ECB, and the BIS's asset position vis-à-vis commercial banks (taken from the 2004 *BIS Annual Report*), are subtracted from the aggregate liabilities of BIS reporting banks to official monetary authorities.

[5] Liabilities vis-à-vis banks in the BIS data include liabilities to both commercial banks and central banks. The data from the IMF track total foreign exchange reserves held by monetary authorities in emerging markets, whether placed with banks abroad (and thus captured in the BIS data) or held in another form (eg debt securities).

Cross-border bank flows to emerging economies

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

	Banks' positions[1]	2002	2003	2003				2004	Stocks at end-Mar 2004
		Year	Year	Q1	Q2	Q3	Q4	Q1	
Total[2]	Claims	–37.0	65.0	34.3	–4.6	20.6	14.7	67.1	1,080.3
	Liabilities	–45.9	71.9	11.0	–10.3	28.2	43.1	101.5	1,324.4
Argentina	Claims	–11.8	-8.5	–1.9	0.9	–5.4	–2.1	–2.5	21.2
	Liabilities	0.0	–0.8	0.5	0.1	–2.2	0.7	0.2	25.0
Brazil	Claims	–11.2	–7.2	2.2	–1.7	1.4	–9.1	1.8	85.5
	Liabilities	–8.0	14.4	3.3	6.6	7.9	–3.4	4.9	61.7
China	Claims	–12.4	13.5	16.0	–6.4	4.9	–1.0	13.9	75.0
	Liabilities	–3.6	–6.4	1.4	–11.3	1.8	1.8	18.3	107.6
Czech Rep	Claims	2.3	3.7	0.7	0.5	0.8	1.7	–1.6	18.2
	Liabilities	–3.7	–2.4	–1.8	0.1	0.2	–0.9	–2.6	7.4
Indonesia	Claims	–6.0	–4.6	–1.0	–1.0	–1.9	–0.8	0.3	29.2
	Liabilities	–2.4	0.2	0.4	–0.1	–0.5	0.3	–0.3	12.2
Korea	Claims	8.2	–1.0	2.3	–2.0	–1.5	0.1	14.2	91.6
	Liabilities	0.5	7.3	–0.8	–6.1	2.1	12.1	21.7	61.7
Mexico	Claims	3.1	–0.7	–0.5	–0.1	0.8	–0.9	6.4	71.6
	Liabilities	–11.4	6.2	4.5	2.2	–0.3	–0.1	3.1	65.1
Poland	Claims	2.9	3.3	0.9	0.9	1.0	0.4	2.4	35.3
	Liabilities	–3.1	–0.1	0.8	–1.1	–1.0	1.2	3.0	21.8
Russia	Claims	3.6	12.1	1.8	1.7	2.8	5.8	3.5	55.5
	Liabilities	9.6	16.2	5.6	–4.4	7.2	7.9	4.9	62.6
South Africa	Claims	–0.4	–1.2	–0.2	0.5	–0.9	–0.7	–0.1	18.5
	Liabilities	2.7	9.7	0.6	4.8	1.4	2.8	4.1	36.3
Thailand	Claims	–5.0	–1.6	–0.3	0.3	0.0	–1.6	–1.0	18.0
	Liabilities	–4.6	5.7	2.5	–0.9	0.9	3.2	–1.5	16.2
Turkey	Claims	–2.8	5.3	2.4	–0.5	3.4	0.1	4.1	48.1
	Liabilities	0.0	–0.4	–3.9	1.5	1.0	0.9	2.8	23.1
Memo:									
EU accession countries[3]	*Claims*	*10.1*	*21.9*	*5.8*	*1.4*	*5.6*	*9.1*	*4.4*	*130.6*
	Liabilities	*–6.4*	*–-0.8*	*–2.1*	*–1.2*	*2.0*	*0.5*	*4.1*	*70.6*
OPEC members	*Claims*	*–9.9*	*–6.5*	*–0.1*	*–6.5*	*–1.9*	*2.0*	*9.2*	*139.1*
	Liabilities	*–8.8*	*–15.1*	*–5.2*	*–11.8*	*–10.2*	*12.2*	*16.1*	*266.9*

[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.

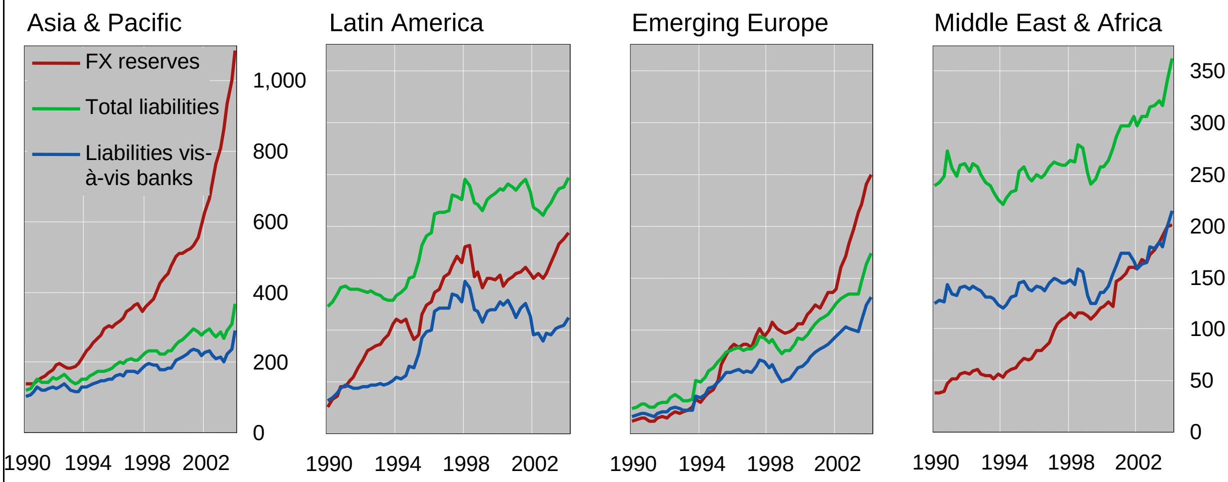
Table 2.2

$107 billion. At the same time, total liabilities of BIS reporting banks vis-à-vis banks in these same countries expanded by $88 billion, driven by an increase in deposits.[6]

[6] The countries included in these calculations are those emerging markets for which the IMF provides total foreign exchange reserve data (excluding those countries classified by the IMF as emerging markets but classified by the BIS as offshore centres). For Taiwan (China), total reserves minus gold is used, whereas total foreign exchange reserves is used for all other countries.

FX reserves and BIS reporting banks' liabilities

Amounts outstanding, in billions of US dollars



Sources: IMF; BIS.

Graph 2.3

Over the longer term as well, changes in foreign exchange reserves seem to have been an important driver of BIS reporting banks' deposit liabilities to the banking sector in emerging markets. While this relationship is quite strong for several key countries, it is far from perfect for a number of reasons (see box on page 18). Overall, this link is clearest in Latin America, where Brazil and Mexico are the major reserve holders, but much weaker in Asia-Pacific, where China and Taiwan (China)[7] are the dominant countries. A longer-term analysis suggests that across all emerging markets, a $1 increase in foreign exchange reserves is associated with a 17 cent increase in deposit liabilities vis-à-vis banks.

Banks across Asia deposit funds abroad

Outflow from Asia-Pacific driven by ...

The largest placement of deposits came from banks in Asia-Pacific, fuelling an even larger net outflow of funds from the region than that which occurred in the previous quarter. Banks in Korea, India, China and, to a lesser extent, Malaysia contributed to a $62 billion increase in deposits placed abroad, bringing total liabilities of BIS reporting banks vis-à-vis banks in the region to $297 billion. While this region also saw the most significant growth in foreign exchange reserves, it was not always in those countries which deposited funds abroad. New credit to banks in the region was also exceptionally strong, with $29 billion in new loans flowing to banks, primarily in Korea, China and Taiwan.

[7] Hereafter Taiwan.

Exploring the link between BIS banks' liabilities and foreign exchange reserves

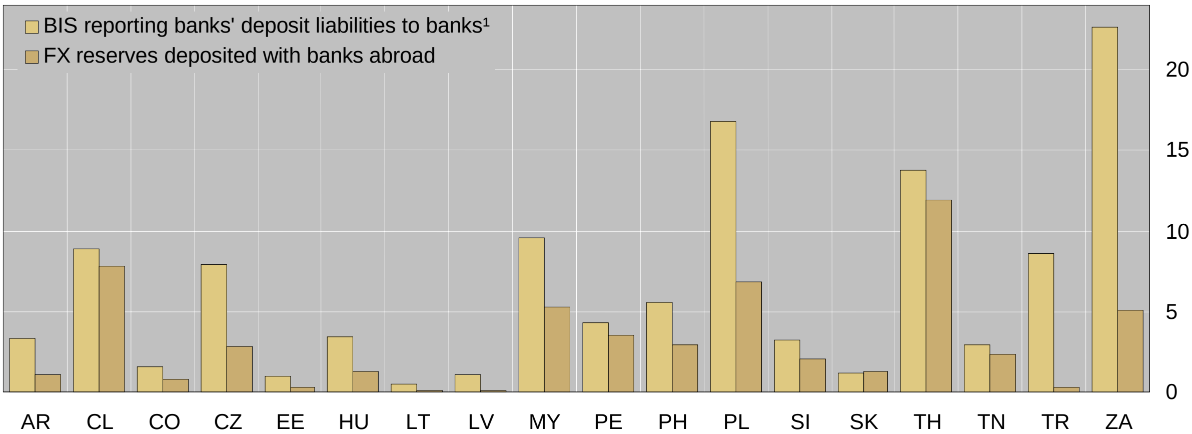
In many emerging markets, a large portion of foreign exchange reserves managed by the monetary authority is placed as deposits with commercial banks outside the country. Indeed, it appears that in several countries, these bank deposits placed abroad dwarf those placed by commercial banks, and account for a significant share of BIS reporting banks' deposit liabilities to these countries' banking sector. In several key emerging markets, however, only a small fraction of foreign exchange reserves is held as deposits in banks abroad. Drawing on several data sources, this box explores the link between emerging markets' foreign exchange reserves and the BIS banking data. Overall, the link between reserves and BIS reporting banks' deposit liabilities to banks appears to be quite strong for many countries, particularly in Latin America and emerging Europe, although regional differences are quite apparent.

Several emerging market countries provide data to the IMF on the *portion* of their monetary authorities' total foreign exchange reserves that is placed as deposits with banks abroad (Graph A). At end-2003, for example, more than three quarters of the BIS reporting banks' deposit liabilities vis-à-vis banks in Chile, Peru, Slovakia, Thailand and Tunisia, and more than half vis-à-vis those in Columbia, Malaysia, the Philippines and Slovenia, were accounted for by deposits of foreign exchange reserves (assuming these reserves were placed with banks in BIS reporting countries). Moreover, inspection of the time series data indicates that movements in reserves often drive the quarterly swings in the BIS deposit liability data, even for some countries where the stocks of reserves and deposit liabilities are quite different. However, many key countries do not report to the IMF, in particular Brazil, China, Korea, Mexico, Russia and Taiwan.

A less direct comparison between the BIS data and *total* foreign currency reserves is potentially useful in explaining movements in the BIS data, as these data are available for a much larger sample of countries. However, such a comparison is not without problems. The total reserve figures include investment in debt securities and deposits placed with other monetary institutions, domestic banks and banks abroad.[①] In general, only the latter are captured in the BIS banking data.[②] Moreover, for any particular emerging market, the BIS data record only the aggregate deposit liability position vis-à-vis banks, which includes deposit liabilities vis-à-vis the commercial

Emerging market deposits of FX reserves and deposit liabilities of BIS reporting banks

End-2003, in billions of US dollars



AR = Argentina, CL = Chile, CO = Colombia, CZ = Czech Republic, EE = Estonia, HU = Hungary, LT = Lithuania, LV = Latvia, MY = Malaysia, PE = Peru, PH = Philippines, PL = Poland, SI = Slovenia, SK = Slovakia, TH = Thailand, TN = Tunisia, TR = Turkey, ZA = South Africa.

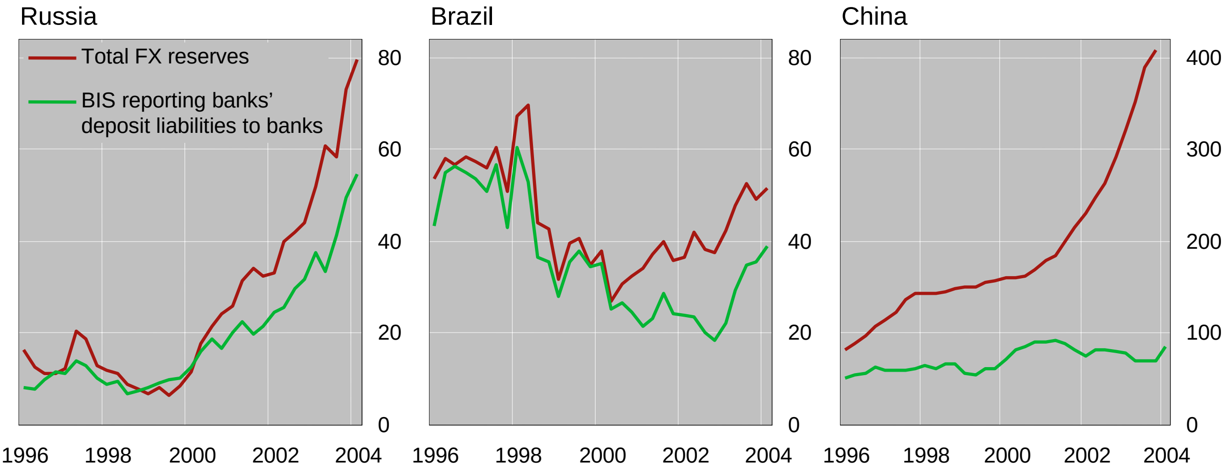
[1] Deposit liabilities vis-à-vis banks in the country shown.

Sources: IMF; BIS calculations. Graph A

① The SDDS data imply that for the 18 countries listed in Graph A, on average roughly one quarter of total foreign exchange reserves are held as deposits with banks abroad. Robert McCauley and Ben Fung in "Choosing instruments in managing dollar foreign exchange reserves", *BIS Quarterly Review*, March 2003, estimate that, globally, 3% of total US dollar-denominated reserve assets are held as deposits in banks in the United States, and an additional 12% in banks offshore. ② Foreign currency deposits placed in banks located in the emerging market are captured in cases where the emerging market is also a BIS reporting country.

Emerging market total FX reserves and deposit liabilities of BIS reporting banks

In billions of US dollars



Sources: IMF; BIS. Graph B

banking sector as well as the monetary authority. Finally, in some countries, foreign exchange reserves are managed not by the monetary authority, but by separate institutions which may not be classified as banks in the BIS banking data. Thus, the extent to which the movements in the BIS banks' stock of deposit liabilities to a particular country's banking sector reflect that country's placement of foreign exchange reserves with banks abroad will depend not only on the portion of reserves held as bank deposits abroad, but also on the size of the reserve position relative to the size of the domestic banking sector.

That said, inspection of the data reveals that the stock of deposit liabilities vis-à-vis banks located in many emerging markets and these countries' stock of foreign exchange reserves do indeed move together. While the cases of Russia and Brazil are fairly obvious (Graph B, left-hand and centre panels), the co-movement is also quite strong for Argentina, Mexico, Libya and, to a lesser extent, Korea, all countries with a relatively large share of the total reserves of monetary authorities within their respective regions. For other large reserve-holding countries, such as China (Graph B, right-hand panel), Taiwan and India, the relationship is considerably less clear.

The broad regional links between movements in reserves and deposits placed with banks abroad can be assessed using simple regression analysis. On the margin, deposit liabilities to banks in all emerging markets, on average, rise by \$0.17 for a \$1 increase in reserves (see table below). This figure obscures the considerable heterogeneity across regions. In Latin America, for instance, the coefficient is much larger, implying 76 cents on the dollar. This is driven by the relatively high degree of co-movement in the reserve and deposit liability data series for Brazil and Mexico, countries which together account for roughly 60% of Latin America's reserves. At the other extreme, the coefficient for Asia-Pacific is *statistically insignificant* because of the inclusion of China and Taiwan, countries which together hold over 60% of the region's total foreign exchange reserves. Excluding these countries, the coefficient for this region rises to 10 cents on the dollar, much closer to the overall rate.

Sensitivity of BIS reporting banks' liabilities to foreign exchange reserves

OLS panel regression results[1]

Dependent variable: Change in liabilities	All emerging markets	Latin America	Asia-Pacific	Asia-Pacific excl China & Taiwan	Emerging Europe	Middle East & Africa
Change in reserves	0.17	0.76	–0.03	0.10	0.22	0.34
R-squared	0.06	0.51	0.03	0.04	0.16	0.04

[1] Estimates are based on panel regressions of the change in BIS reporting banks' deposit liabilities to banks in emerging market countries on the change in foreign exchange reserves held by the authorities in these emerging markets. These regressions are run on data from 131 emerging market countries covering the period from the first quarter of 1996 to the first quarter of 2004. Foreign exchange reserve data are missing for some countries in some years. All regressions include a constant term and country dummy variables. All coefficients with the exception of that for Asia-Pacific (including China & Taiwan) are statistically significant at standard confidence levels.

Banks in Korea placed the most funds abroad, leading to the third consecutive quarterly net outflow of funds from the country. Across all sectors, Korea remains the BIS reporting banks' largest net debtor in Asia-Pacific. However, a $22 billion increase in deposits in banks in offshore centres pushed total net claims vis-à-vis all sectors in Korea down to $30 billion from $37 billion in the previous quarter and $50 billion at end-September 2003. This rise in deposits abroad dwarfs that in foreign exchange reserves over the same period, which went up by only $8.2 billion, implying that it was mostly commercial activity.

... deposits from banks in Korea, India and China

Increases in deposits were also behind net outflows from India and China. India experienced its largest net outflow in the BIS coverage period as banks in the country placed $11 billion with BIS reporting banks, primarily in the United Kingdom and offshore centres. This drove total liabilities vis-à-vis all sectors in India to $41 billion, in a quarter in which foreign exchange reserves held by the Reserve Bank of India expanded by $9.8 billion. China also deposited substantial funds with BIS reporting banks, the first increase in seven quarters. Banks in China placed $14.6 billion in new deposits (largely denominated in US dollars) with BIS reporting banks, primarily in offshore centres. This brought net liabilities vis-à-vis banks in China to $29 billion ($85 billion gross), second only to that vis-à-vis banks in Russia.

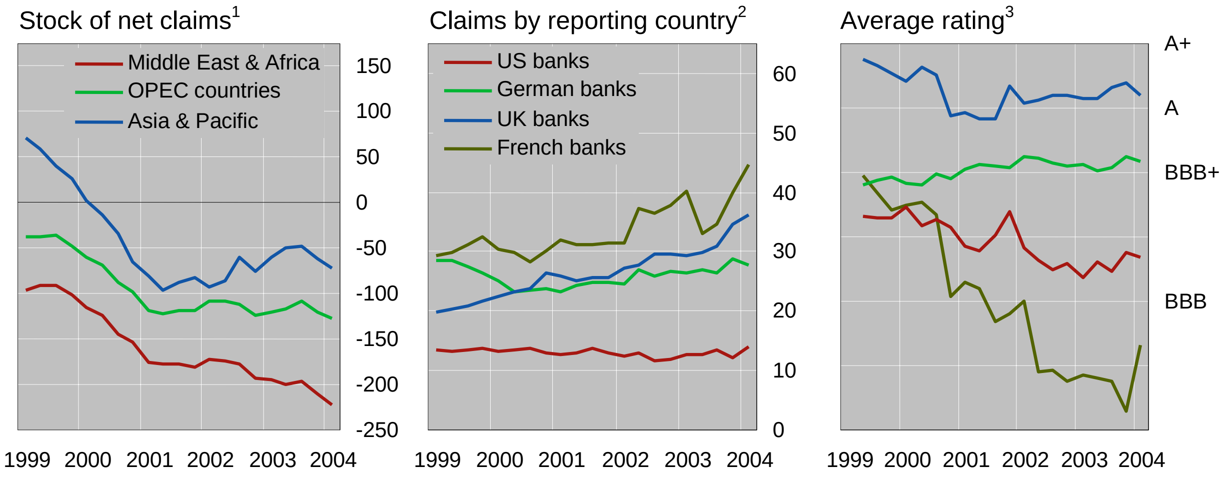
Net outflow from Middle East and Africa grows

Funds also flowed out of the Middle East and Africa, as banks in the region placed substantial funds with BIS reporting banks. A $15 billion increase in deposits by banks in Saudi Arabia, much of it denominated in euros, pushed total liabilities vis-à-vis the region to $408 billion. In absolute terms, this is less than the stock of liabilities of BIS reporting banks vis-à-vis Asia-Pacific, at $440 billion. However, amongst emerging market regions, the Middle East and Africa is by far the largest net supplier of funds to the international banking market (Graph 2.4, left-hand panel). Reflecting the surpluses generated by OPEC member countries, the region as a whole contributed a net $223 billion compared to $73 billion from Asia-Pacific.

Short-term credit to borrowers in the Middle East and Africa is on the rise

Banks in the reporting area also directed short-term credit to banks and the public sector in the Middle East and Africa. The BIS consolidated data indicate that both international and local currency claims on the region have tended to rise since early 2003, with the largest increase coming in the most recent quarter. Total foreign claims vis-à-vis the region surged to $198 billion (on an ultimate risk basis), fuelled by $5 billion in new short-term international credit from French banks to the Saudi Arabian public sector (Graph 2.4, centre panel). This latest move lifted the average rating of French banks' Middle East and Africa asset portfolio to near a BBB rating (Graph 2.4, right-hand panel). More generally, short-term claims on Saudi Arabia have trended upwards since at least mid-2001, reaching 84% of total international claims on the country in the first quarter from 74% in the previous one and 67% a year earlier.

Positions vis-à-vis the Middle East and Africa



[1] BIS locational banking statistics: total claims outstanding minus total liabilities of BIS reporting banks, in billions of US dollars. [2] BIS consolidated banking statistics: foreign claims outstanding on an ultimate risk basis, in billions of US dollars. [3] Average rating of the Middle East and Africa asset portfolio. See the box on pages 22–3 of the 2003 September *BIS Quarterly Review* for details on the calculation.

Graph 2.4

Outflow from Latin America continues

An eighth consecutive quarter of net outflows from Latin America also reflected increased deposits placed abroad. Borrowers in the region deposited $13.2 billion with BIS reporting banks, overshadowing new credit and thus resulting in a net outflow of $9 billion. The link between foreign exchange growth and changes in liabilities of BIS reporting banks seems to be particularly strong in Latin America. For example, these series for Brazil, which accounts for over one quarter of the region's foreign exchange reserves, have tended to move together since at least 1995 (see Graph B in the box on page 18). This is also the case, although to a lesser extent, for Mexico, which accounts for roughly one third of the region's reserves.

Deposits from Brazil and reduced credit to Argentina drive outflow from Latin America

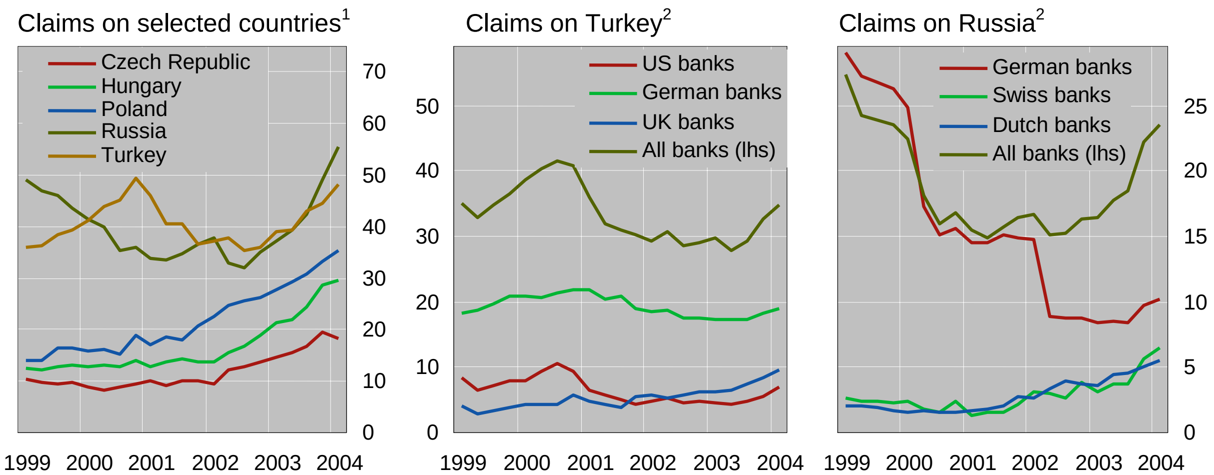
Movements vis-à-vis Brazil and Argentina were behind much of the large net outflow from the region as a whole. Accompanying a rise in foreign exchange reserves, banks in Brazil deposited $3.9 billion abroad, primarily with banks in the euro area and Japan. Although partially offset by purchases of international debt securities issued by banks in Brazil, the growth in deposits led to a net outflow of $3.1 billion. A third consecutive quarterly decline in lending to all sectors in Argentina also contributed to the net outflow from the region. While the decrease in credit to the Argentine banking sector probably reflected the continued writedown of loan positions following the country's default, loans to non-banks also continued to fall (for the ninth consecutive quarter), this time by $1.2 billion.

Inflow to emerging Europe despite large placement of deposits

Only in emerging Europe did new credit outpace deposits, generating a net inflow to the region for the sixth consecutive quarter. New claims on the region as a whole, at $13.3 billion, were directed at non-banks and took the form of loans as well as purchases of international debt securities issued by these

Claims vis-à-vis emerging Europe

Amounts outstanding, in billions of US dollars



[1] BIS locational banking statistics. [2] BIS consolidated banking statistics: foreign claims on an ultimate risk basis.

Graph 2.5

borrowers. Residents in the region also placed $10.9 billion in deposits with BIS reporting banks, the second largest increase for the region in the BIS coverage period. Much of this was accounted for by Russia, which also recorded a relatively large increase in foreign exchange reserves in the first quarter, although banks in Poland and non-banks in Turkey contributed to this rise too.

Inflow to emerging Europe reflects new lending to Turkey ...

Over half of the new loans to the region were to non-bank borrowers in Turkey. Loans from banks in offshore centres and the United States accounted for the bulk of $2.6 billion in new loans to these borrowers, pushing total claims on the country to $48 billion (Graph 2.5, left-hand panel). Although Turkey is no longer the largest borrower in the region, the stock of claims has returned to levels not seen since late 2000, after bottoming out in mid-2002. German banks remain Turkey's biggest creditors, with total foreign claims (on an ultimate risk basis) of $9.5 billion, although the exposure of US, UK and other euro area banks has been on the rise in recent quarters as well (Graph 2.5, centre panel).

... and increased deposits from banks in Russia

Residents in Russia deposited substantial sums abroad for a third consecutive quarter, concurrent with an increase in foreign exchange reserves held by the Russian central bank. A $5.3 billion deposit by banks in Russia drove total liabilities vis-à-vis all sectors in the country to $62.6 billion. Claims on non-banks in Russia also rose for the sixth consecutive quarter, this time by $2.6 billion, pushing the total stock of net claims on the country to $25.6 billion, second behind Mexico among emerging markets. In the most recent quarter under review, banks in the United Kingdom purchased $1.8 billion in international debt securities issued by non-bank borrowers, much of it US dollar-denominated.

International syndicated credits in the second quarter of 2004

Jesper Wormstrup

Signings of international syndicated loans reached an all-time high in the second quarter. Supported by refinancing deals worth an unprecedented $240 billion, total signings exceeded $500 billion for the first time (see left-hand panel of graph below). The high level of refinancing deals is to some extent a result of borrowers taking advantage of benign financing conditions to prefinance existing facilities scheduled to mature at a later stage.

In line with the historical average, deals denominated in US dollars made up 75%, followed by 15% denominated in euros and 5% in sterling.

Borrowing by US entities was particularly buoyant. Total signings came to a record $325 billion, an increase of nearly 75% over the same quarter last year. Refinancing deals comprised $123 billion or 38% of the total, some 10 percentage points higher than the historical average. Large amounts were obtained by the energy, insurance and retail sectors. In addition, the financial services sector showed a marked presence, with signings totalling $50 billion, nearly half of which, $22.4 billion, was secured by General Electric Capital Corp, making it the largest individual borrower in the second quarter.

Although less momentous than US borrowing, activity by western European borrowers was still sizeable. In a total of $134 billion, refinancing deals comprised a striking 75% compared with a historical average of 50%. The largest individual deals were arranged for German automobile manufacturer Volkswagen AG (€11 billion) and France Telecom (€10 billion). While the largest amounts were raised by French, German and UK entities, the marked increase in Scandinavian borrowing is worthy of note.

Borrowing by emerging market entities remained robust in the second quarter (see right-hand panel of graph below). Total borrowing came to $27.8 billion, the highest level of any second quarter since 1997. As often before, the highest amount ($10.5 billion) was secured by Asian entities. Taiwanese corporates, mainly in the electronics sector, accounted for $4 billion. Malaysian financial institutions and corporates raised $1 billion each, and another $1.1 billion was obtained by the Korean corporate sector.

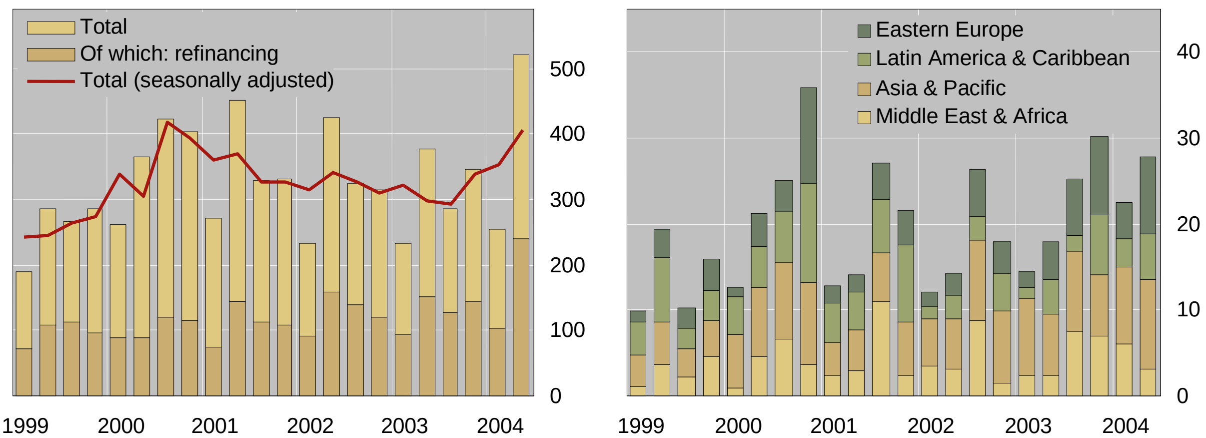
Business in eastern Europe was also brisk, with signings totalling $9 billion. Russian entities, predominantly oil and mining companies and commercial banks, were the most active, with total borrowing amounting to $3.8 billion. Hungarian banks signed deals worth $1.1 billion and the Bulgarian telecommunications company Mobiltel EAD raised €650 million to buy back its own shares. This was the largest ever signing by a Bulgarian entity in the international syndicated credit market.

In Latin America, borrowing was primarily driven by the Mexican corporate sector. The national oil company Pemex rolled over $1.25 billion, and another $2.3 billion was secured by private corporates. In a total of $3.1 billion for the Middle East and Africa region, two thirds was accounted for by the South African insurance company Old Mutual plc through a £1.1 billion refinancing deal, the largest emerging market signing in the second quarter.

Activity in the international syndicated credit market

In billions of US dollars

Signed facilities | Facilities for emerging economies



Sources: Dealogic Loanware; BIS.