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2. The international banking market

Following exceptional growth in the first quarter of 2004, cross-border activity in the international banking market was muted in the second. US dollar- and euro-denominated business was particularly weak, as investors unwound securities positions in the face of rising bond yields in the United States and elsewhere. By contrast, yen-denominated claims exhibited signs of growth. US dollar credit to non-bank borrowers fell for the first time since late 2002, particularly to borrowers in the United States. This was offset by a modest uptick in interbank lending.

Emerging market economies as a whole experienced a net inflow of funds, even as the differences across regions persisted. Funds continued to flow out of Latin America, while increased lending to banks in Asia-Pacific led to a net inflow there. Claims on borrowers in emerging Europe grew, although a large placement of deposits with BIS reporting banks resulted in a net outflow from the region. Despite the rise in oil prices in the second quarter, deposits placed with BIS reporting banks by oil-exporting countries decreased. Moreover, since mid-2001, when the most recent run-up in oil prices began, the currency composition of banks' net liabilities vis-à-vis oil-producing countries has shifted slightly away from the US dollar.

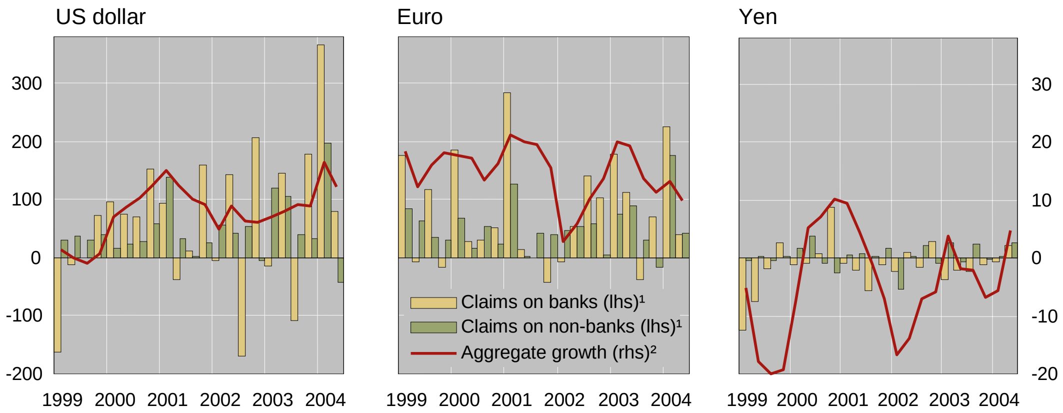
Second quarter calm follows first quarter surge in claims

Weak claim growth despite pickup in interbank activity

Following an exceptional surge in the first quarter, total claims rose only modestly in the second. US dollar- and euro-denominated business was noticeably weak, as investors unwound positions amidst the rise in bond market yields in the second quarter.[1] Only yen activity showed signs of life (Graph 2.1). Interbank claims of BIS reporting banks were up by $200 billion, accounting for over 80% of the total increase in claims. New credit to corporate and other non-bank borrowers was stagnant, rising by only $40 billion, over three quarters of which flowed to entities in offshore centres. Combined, these moves pushed total claims up a mere 1.4% from the previous quarter, driving down the year-over-year growth rate to 11% (from 14% in the previous quarter).

1 See the Overview of the June 2004 *BIS Quarterly Review* for discussion.

Cross-border claims by sector and currency



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

US dollar activity weak as lending to non-banks declines

US dollar-denominated activity was particularly weak in the second quarter, owing largely to a decrease in credit to non-bank borrowers in the United States. Total US dollar-denominated claims rose by $38 billion, as stronger interbank activity offset a fall in claims on non-bank borrowers. Movements in the interbank market were somewhat unusual in that investment in international debt securities issued by banks overshadowed actual lending between banks.[2] Total US dollar claims on *non-bank* borrowers globally actually fell by $42 billion, the first outright decrease since end-2002, and the largest in the BIS coverage period.[3]

Securities firms unwind repo positions

Most significantly, loans to non-bank borrowers in the United States decreased for the first time since the third quarter of 2001. This $57 billion contraction occurred during a quarter in which *domestic* short-term financing (bank loans and commercial paper issuance) rose, and thus is not necessarily evidence of weak corporate loan demand.[4] Rather, this drop in international loans probably reflected the unwinding of repo positions by securities firms

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[2] Interbank claims rose by $80 billion. Almost one third of this reflected inter-office activity, while $32 billion was accounted for by international debt security claims. Banks in offshore centres purchased securities issued by banks in the United Kingdom, other offshore centres and China, and banks in the United States purchased securities issued by banks in Canada and the United Kingdom.

[3] Loans to non-banks borrowers contracted by $51 billion, accompanied by a drop in international debt security claims. This was partially offset by purchases of equities issued by US residents by banks in offshore centres and, to a lesser extent, the United Kingdom.

[4] The US flow of funds data for the second quarter of 2004 indicate that bank loans to non-farm non-financial corporate businesses rose by $22 billion, the first increase since 2000. In addition, commercial paper issuance rose by $34.4 billion in the first quarter of 2004 and by $32.9 billion in the second.

between mid-March and mid-May, when yields on US Treasuries widened by 100 basis points. The financing of securities trading through repo transactions, in particular the link between banks in the United Kingdom and securities firms in the United States, seems to be an increasingly important determinant of international bank flows.[5] Consistent with this unwinding, the overall decrease in loans to the non-bank sector in the United States in the most recent quarter was largely the result of reduced positions of banks in the United Kingdom and offshore centres. In addition, holdings by banks in the United Kingdom of US dollar-denominated international debt securities issued by non-banks in the United States fell by $14 billion, also the largest drop recorded in the BIS reporting period.

Globally, the overall contraction in loans to non-banks would have been more severe if not for a sizeable increase in loans to borrowers in the Cayman

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-Jun 2004
	Year	Year	Q2	Q3	Q4	Q1	Q2	
Total cross-border claims	740.1	1,076.4	492.6	–110.0	315.8	1,232.5	239.8	17,341.4
on banks	425.0	531.0	306.7	–229.5	277.1	826.9	200.0	11,247.8
on non-banks	315.2	545.4	185.9	119.5	38.7	405.5	39.8	6,093.6
Loans: banks	395.4	452.9	324.3	–263.8	249.3	727.9	128.5	9,554.8
non-banks	103.8	277.0	24.8	92.3	18.1	196.2	–32.6	3,163.1
Securities: banks	36.3	75.8	–8.2	22.5	35.1	76.0	58.9	1,205.0
non-banks	202.2	208.3	122.9	8.3	6.5	192.2	31.3	2,570.7
Total claims by currency								
US dollar	320.4	500.3	252.4	–68.3	210.9	562.8	37.8	6,922.2
Euro	453.3	502.9	202.6	–8.0	53.9	400.9	82.8	6,381.1
Yen	–42.3	–50.5	–25.4	0.7	–15.0	–1.9	49.4	820.7
Other currencies[2]	8.7	123.7	64.2	–34.5	65.9	270.7	69.8	3,217.4
By residency of non-bank borrower								
Advanced economies	315.1	459.0	159.9	103.3	47.0	344.5	11.2	4,771.6
Euro area	117.4	157.3	67.5	50.5	–17.7	151.4	32.4	2,174.1
Japan	4.1	38.4	15.6	6.5	–5.2	0.1	20.4	200.2
United States	153.1	179.6	60.0	40.9	53.0	87.3	–41.1	1,557.1
Offshore centres	18.8	100.0	18.9	10.2	–10.1	41.6	30.7	702.9
Emerging economies	–16.5	5.1	3.3	4.9	3.1	23.9	1.1	574.5
Unallocated[3]	–2.2	–18.7	3.8	1.1	–1.3	–4.5	–3.1	44.6
Memo: Local claims[4]	*44.5*	*415.2*	*88.8*	*51.7*	*94.1*	*187.5*	*35.1*	*2,527.1*

[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

[5] See the special feature on “A shift in London’s eurodollar market” in the September 2004 *BIS Quarterly Review* for discussion.

Islands. Banks in the United States channelled $17 billion in loans to these borrowers, while banks in the United Kingdom and the euro area contributed an additional $1.4 billion, driving total claims on non-bank borrowers in the Cayman Islands to $221 billion, or 9% of total US dollar claims on non-bank borrowers (up from 8% in the previous two quarters). This lending may have been the result of greater hedge fund activity; estimated inflows into hedge funds, many of which are legally domiciled in the Cayman Islands, were again robust in the second quarter.

Pickup in yen-denominated claims

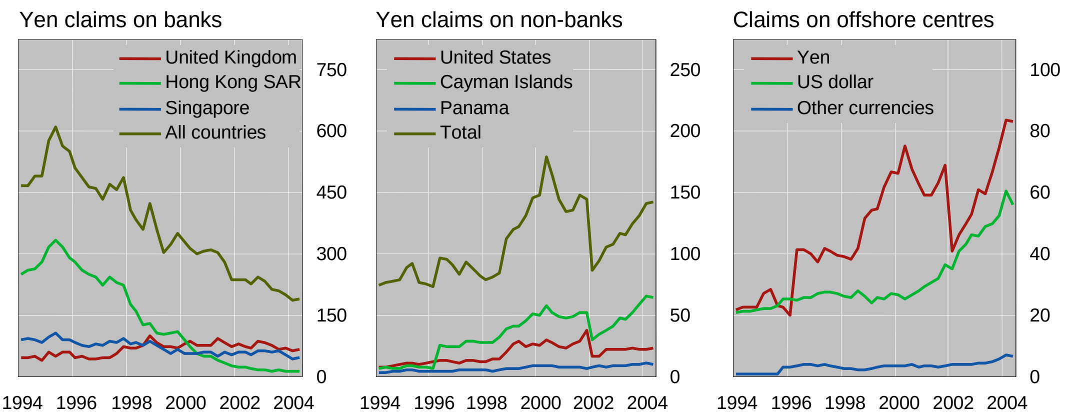
Japanese interbank activity drives a rise in yen claims

Yen-denominated claims picked up in the second quarter of 2004, although hardly enough to offset the weak claims growth in other currencies (Graph 2.1). The $49 billion increase in total claims was the largest since the last quarter of 2000, and mainly reflected new claims of banks in Japan ($19 billion), the United Kingdom ($15 billion) and Luxembourg ($14 billion). Banks in the United Kingdom laid off $11 billion in yen with banks in Japan, in addition to smaller amounts with those in the Cayman Islands and the United States. At the same time, yen-denominated international debt security claims of banks in the United Kingdom vis-à-vis non-banks in Japan dropped by $8.7 billion, even as Japanese borrowers issued a net $11 billion in international debt securities (and announced $33 billion).[6]

The resurgence in yen lending by Japanese banks, while not particularly large by historical standards, was perhaps the most noteworthy. Total claims of banks in Japan rose by $31 billion in the second quarter, less than the $44 billion expansion in the first quarter, but significant nonetheless because this growth reflected both yen ($19 billion) and US dollar ($14 billion) claims.

Claims of banks in Japan

In billions of US dollars

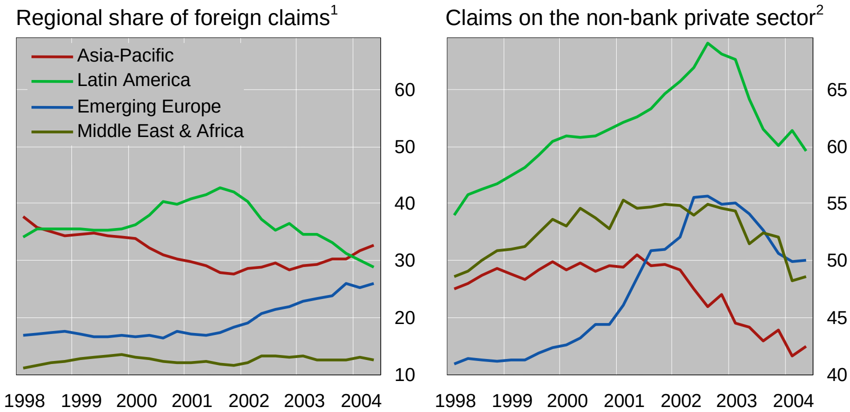


Graph 2.2

[6] See "The international debt securities market" in the September 2004 *BIS Quarterly Review* for discussion.

Consolidated claims on emerging markets

In per cent



[1] Share of total foreign claims, on an ultimate risk basis, on all emerging markets. [2] Share of total international claims for each region.

Graph 2.3

Although yen-denominated interbank activity of banks in Japan has been on the decline since at least 1995 (Graph 2.2, right-hand panel), lending to other banks accounted for over half of their overall yen-denominated activity in the most recent quarter, the first rise in lending to this sector in six quarters. Conversely, their yen-denominated lending to non-banks, primarily those in offshore centres, has been on the increase since the second quarter of 2002.

Shift out of Latin America and into Asia continues

Banks continue to shift out of Latin America ...

New lending to emerging markets slightly outpaced a small rise in deposits placed abroad, yielding the first net inflow to these economies in a year. The aggregate figures, however, mask significant differences across regions. Funds flowed out of Latin America and emerging Europe, while new lending to banks in Asia-Pacific drove a net inflow there. The BIS consolidated statistics, which net out inter-office positions, indicate that reporting banks' exposures shifted further towards Asia-Pacific and emerging Europe and out of Latin America in the second quarter of 2004, a continuation of a trend evident since at least end-2001 (Graph 2.3). Foreign claims (ultimate risk basis) on Latin American borrowers dropped to $450 billion, or 29% of total foreign claims on emerging markets, from 30% in the previous quarter and 35% a year earlier.

Latin America turns into a net contributor of funds

Banks continued to reduce their exposures to countries in Latin America, driving the ninth consecutive quarterly net outflow from the region. While large placements of deposits in BIS reporting banks have, in recent quarters, contributed to these outflows, the $5.1 billion net outflow in the most recent quarter was primarily due to a $6.3 billion fall in claims on the region. However, differences across countries were substantial. Venezuela experienced the most significant net outflow, the result of increased deposits placed abroad in a

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-Jun 2004
		Year	Year	Q2	Q3	Q4	Q1	Q2	
Total[2]	Claims	–37.0	65.0	–4.6	20.6	14.7	67.9	26.1	1,102.6
	Liabilities	–45.9	71.9	–10.3	28.2	43.1	107.5	21.7	1,346.8
Argentina	Claims	–11.8	–8.5	0.9	–5.4	–2.1	–2.6	–1.1	20.0
	Liabilities	0.0	–0.8	0.1	–2.2	0.7	0.3	0.1	25.2
Brazil	Claims	–11.2	–7.2	–1.7	1.4	–9.1	1.8	–4.0	81.2
	Liabilities	–8.0	14.4	6.6	7.9	–3.4	5.0	–3.6	58.0
China	Claims	–12.4	13.5	–6.4	4.9	–1.0	13.9	10.1	84.6
	Liabilities	–3.6	–6.4	–11.3	1.8	1.8	21.6	20.6	130.9
Czech Rep	Claims	2.3	3.7	0.5	0.8	1.7	–1.7	0.8	18.8
	Liabilities	–3.7	–2.4	0.1	0.2	–0.9	–2.6	2.5	9.9
Indonesia	Claims	–6.0	–4.6	–1.0	–1.9	–0.8	0.3	–0.9	28.1
	Liabilities	–2.4	0.2	–0.1	–0.5	0.3	–0.2	–2.1	33.8
Korea	Claims	8.2	–1.0	–2.0	–1.5	0.1	14.3	–8.5	82.7
	Liabilities	0.5	7.3	–6.1	2.1	12.1	21.7	–4.8	56.6
Mexico	Claims	3.1	–0.7	–0.1	0.8	–0.9	7.5	–0.6	71.8
	Liabilities	–11.4	6.2	2.2	–0.3	–0.1	4.0	–0.7	65.2
Poland	Claims	2.9	3.3	0.9	1.0	0.4	2.4	2.1	37.2
	Liabilities	–3.1	–0.1	–1.1	–1.0	1.2	3.0	3.9	25.6
Russia	Claims	3.6	12.1	1.7	2.8	5.8	3.4	–0.3	55.1
	Liabilities	9.6	16.2	–4.4	7.2	7.9	5.0	7.8	70.3
South Africa	Claims	–0.4	–1.2	0.5	–0.9	–0.7	–0.1	0.3	18.7
	Liabilities	2.7	9.7	4.8	1.4	2.8	4.1	1.8	37.9
Thailand	Claims	–5.0	–1.6	0.3	0.0	–1.6	–1.0	–0.4	17.4
	Liabilities	–4.6	5.7	–0.9	0.9	3.2	–1.5	–0.8	26.4
Turkey	Claims	–2.8	5.3	–0.5	3.4	0.1	4.1	3.4	51.4
	Liabilities	0.0	–0.4	1.5	1.0	0.9	2.9	0.9	24.0
Memo:									
New EU countries[3]	*Claims*	*9.2*	*20.9*	*1.2*	*5.6*	*8.5*	*3.9*	*6.7*	*129.3*
	Liabilities	*–5.9*	*–0.4*	*–1.3*	*2.0*	*0.8*	*3.2*	*4.8*	*69.1*
OPEC members	*Claims*	*–9.9*	*–6.5*	*–6.5*	*–1.9*	*2.0*	*9.2*	*1.4*	*139.8*
	Liabilities	*–8.8*	*–15.1*	*–11.8*	*–10.2*	*12.2*	*16.5*	*–2.4*	*287.3*

[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] Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. Table 2.2

quarter of high and rising oil prices. A smaller outflow from Argentina stemmed from reduced claims vis-à-vis all sectors in the country, as writedowns and repayments continued. Claims on all sectors in Brazil also fell noticeably, by $4 billion, but were largely offset by a repatriation of deposits.

... as region becomes a net creditor ...

On balance, the region has become a net contributor of funds to the international banking system over the last three quarters. This is the result of the continued placement of deposits in BIS reporting banks, as well as the repayment and writing-down of loans vis-à-vis several borrowing countries in the region. Overall, the net stock of claims (total claims minus total liabilities) on the region has turned negative in the last three quarters, driven by growing net liabilities vis-à-vis its banking sector, and waning net claims vis-à-vis the non-bank sector (Graph 2.4, left-hand panel).[7] In particular, the banking sector in Brazil, still an overall net debtor, has accounted for much of the transition, with the stock of net claims on banks in the country falling to $1.5 billion in the most recent quarter from $27 billion in mid-2002. As shown in the centre panel of Graph 2.4, this has primarily been the result of increased deposits placed with BIS reporting banks. At the same time, the fall in net claims on non-banks in Argentina has also been significant (Graph 2.4, right-hand panel), although mainly caused by ongoing loan writedowns and repayments.

... even while issuing bonds

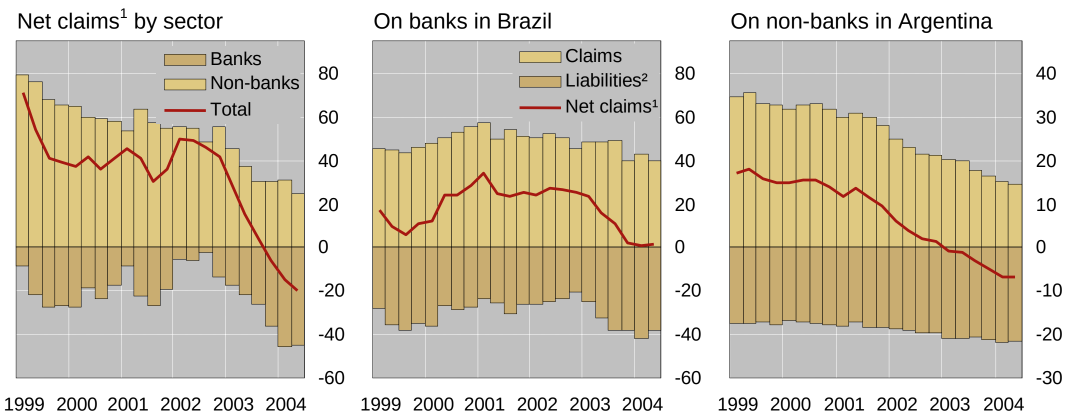
This change has been accompanied by robust issuance of international debt securities by borrowers in the region. Although net issuance by borrowers in Argentina, Brazil and Mexico was negative in the second quarter (Graph 2.5), the longer-term trends are suggestive of a shift away from bank financing and towards bond financing, particularly by non-bank borrowers. International debt securities now account for 59% of total international credit to non-banks in the region, up from 54% in the first quarter of 2001 and 46% in the first quarter of 1999. Concurrent with the rise in securities issuance, the BIS consolidated statistics, which allow for a finer sectoral breakdown of bank claims, indicate that reporting banks' exposure has trended away from the non-bank *private* sector, or those borrowers that have most actively issued securities (Graph 2.3, right-hand panel).

Inflow to Asia-Pacific in spite of China's placement of deposits

New lending to banks in the region, coupled with repatriation of deposits by some countries, contributed to a net inflow to Asia-Pacific. The net stock of

Positions vis-à-vis Latin America and the Caribbean

In billions of US dollars



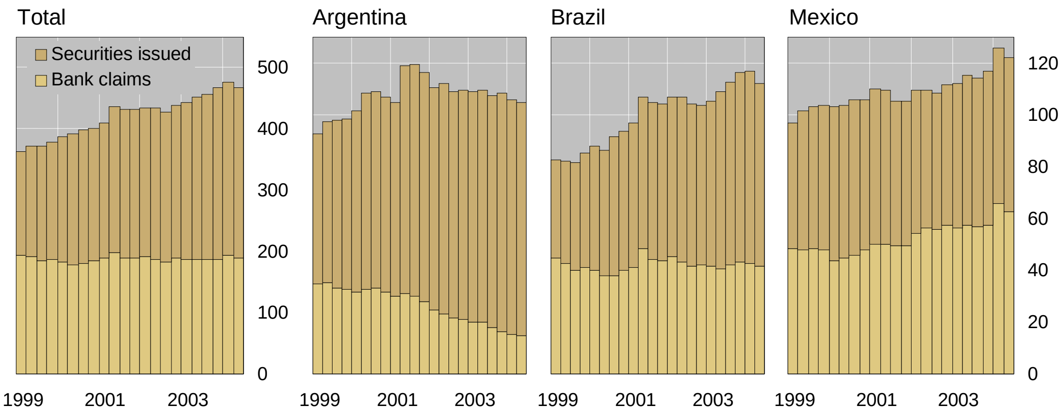
[1] Claims minus liabilities. [2] Inverted.

Graph 2.4

[7] The portion of the total stock of net claims on the region which is not allocated to a particular country has been a contributing factor. It reached –$18.7 billion in the second quarter of 2004,

Credit to non-banks in Latin America and the Caribbean

In billions of US dollars



Graph 2.5

claims on the region has fluctuated in recent quarters under the combined influence of net funds placed abroad by residents of China, and a rise in net claims on residents of Taiwan, China[8] (Graph 2.6, left-hand panel). In the most recent quarter, the stock of net funds channelled to the international banking system from the region fell to $64 billion, after having trended upwards over the previous three quarters. Banks in Taiwan, the Philippines, Indonesia and Korea repatriated deposits while those in China and, to a lesser extent, India placed relatively substantial amounts abroad for the second consecutive quarter.

Deposit repatriation into Taiwan ...

Inflows into Taiwan were the largest in the region, the result of the repatriation of deposits and interbank lending. This possibly reflected expectations of an appreciation of the New Taiwan dollar vis-à-vis the US dollar. Banks in Taiwan repatriated $7.1 billion in US dollar-denominated deposits from banks in the United States, and borrowed a relatively robust $9.4 billion from BIS reporting banks.[9] This led to a $17 billion net inflow into Taiwan, and pushed the net stock of claims vis-à-vis the country closer to positive territory (Graph 2.6, centre panel). At the same time, non-bank residents of Taiwan stepped up their US dollar borrowing from Taiwanese banks for the second consecutive quarter, this time by $2.4 billion.

... despite net outflows from China and Korea

Other countries in the region, in particular China and Korea, experienced net outflows of funds. For the second consecutive quarter, banks in China deposited substantial sums abroad in BIS reporting banks, this time

from –$1.4 billion in the first quarter of 2003. Excluding this unallocated portion, the stock of net claims on the region as a whole turned negative only in the most recent quarter.

8 Hereinafter Taiwan.

9 This deposit repatriation occurred even as Taiwan's total foreign exchange reserves rose in the second quarter. Partly offsetting this large repatriation, banks in Taiwan increased their deposits with banks in the United Kingdom by $2.1 billion.

$21 billion.[10] These were primarily US dollar-denominated deposits, but yen and Hong Kong dollar deposits rose as well (Graph 2.6, right-hand panel). This increase in deposits, though partially offset by $11.5 billion in new interbank lending to banks in China, resulted in a $10.5 billion net outflow from the country. Korea's fourth consecutive net outflow stemmed from reduced lending to all sectors as well as sales of equity claims of BIS reporting banks on non-banks in the country. This decrease in claims was accompanied by a $4.4 billion repatriation of (primarily US dollar) deposits by banks in Korea.

On a consolidated basis, an acquisition of a bank in Korea led to a large increase in local currency claims of US banks on the country's residents. This $36 billion move, which reflected a reclassification of existing claims, was matched by a similar rise in local currency liabilities. This inflated BIS reporting banks' local currency claims on Korea to 48% of total foreign claims on the country, from 29% in the previous two quarters.[11] Excluding the claims of US banks, local currency claims on the region remained stable.

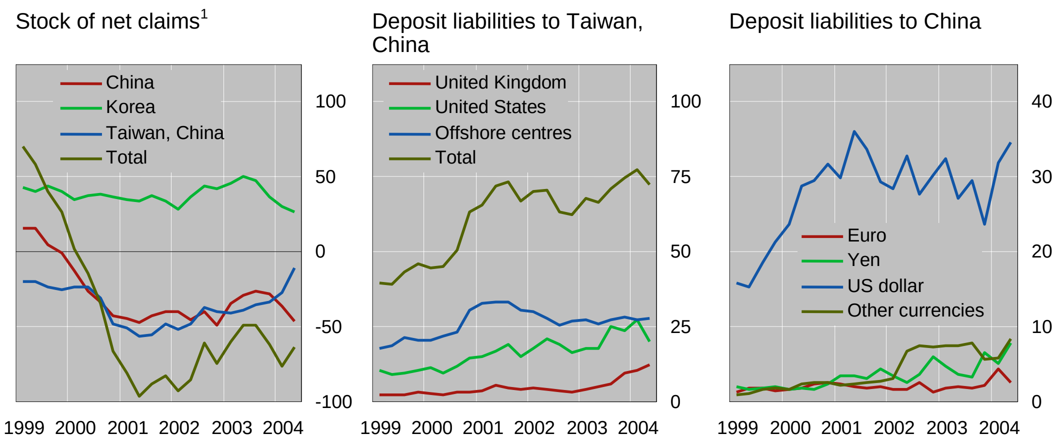
Russian deposits fuel first net outflow from emerging Europe in six quarters

Outflow from emerging Europe ...

Despite relatively strong lending to all sectors in the region, increased deposits placed with BIS reporting banks led to a net outflow of funds from emerging Europe. Claims on all sectors rose for the 11th consecutive quarter, this time by a relatively robust $11 billion. Yet the deposit placements were larger, leading to a $6 billion net outflow, the first since the third quarter of 2002. As in the previous three quarters, the most significant placement was by banks in

Positions vis-à-vis Asia-Pacific

In billions of US dollars



[1] Claims minus liabilities.

Graph 2.6

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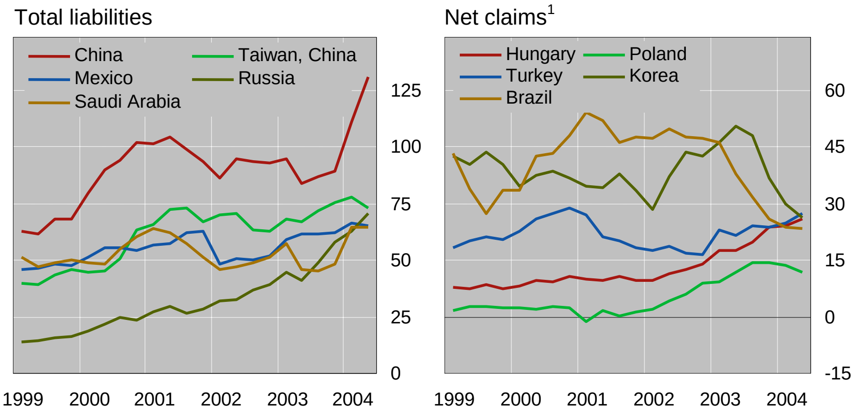
[10] China's total foreign exchange reserves increased from $440 billion in the first quarter of 2004 to $471 billion in the second.

[11] US banks' local currency claims on Korea jumped to 86% of their total foreign claims on the country from 52% in the previous quarter.

Positions vis-à-vis selected emerging market countries

In billions of US dollars



[1] Claims minus liabilities.

Graph 2.7

Russia. However, banks in Poland deposited $3.7 billion while banks in the Czech Republic placed $2.6 billion, partially the result of greater foreign exchange reserves held with banks abroad.[12] This outflow from the region as a whole occurred even as the new EU member countries (collectively) experienced a net inflow of $2 billion.

... driven by Russian deposits ...

Residents of Russia continued to place deposits with BIS reporting banks in the second quarter, driving the net outflow from the region. Banks in Russia placed $7.4 billion in deposits abroad, primarily in banks in the United Kingdom, the United States and France.[13] The domestic liquidity difficulties experienced by some Russian banks in June appear to have had no impact on their international activities. The sustained outflow of deposits since late 2002 pushed the stock of total liabilities of BIS reporting banks vis-à-vis Russia to $70.3 billion, surpassing Saudi Arabia ($64.4 billion) and Mexico ($65.2 billion), and ranking third overall behind China ($130.9 billion) and Taiwan ($72.9 billion) (Graph 2.7, left-hand panel). On a net basis, while Russia still ranks behind many other countries, the contribution of funds to the international banking system by all sectors in Russia has risen to $15.2 billion from Russia being a net borrowing nation in 2002 – more than that contributed by Kuwait and Taiwan and nearly on a par with Egypt and Venezuela.

... despite increased claims on Turkey, Poland and Hungary

Claims on the region were boosted by lending to residents of Turkey, Poland and Hungary. New loans to all sectors in Turkey, primarily from banks in the United Kingdom, pushed total claims on the country to $51.4 billion, placing it second behind Russia in the region. The stock of net claims on both

[12] In the second quarter, the Czech Republic's foreign exchange reserves held with banks abroad increased by $755 million, while Poland's increased by $1.4 billion.

[13] Russia's total foreign exchange reserves increased from $79.6 billion in the first quarter to $84.5 billion in the second.

Turkey and Hungary has trended upwards in recent quarters, as claims vis-à-vis these countries have risen. In the most recent quarter, the net stock of claims on Turkey ($27.4 billion) surpassed that on Korea, making Turkey the largest net borrower among all emerging market countries (Graph 2.7, right-hand panel). Hungary comes in a close second, with the stock of net claims having risen to $26 billion from $17.5 billion a year earlier.

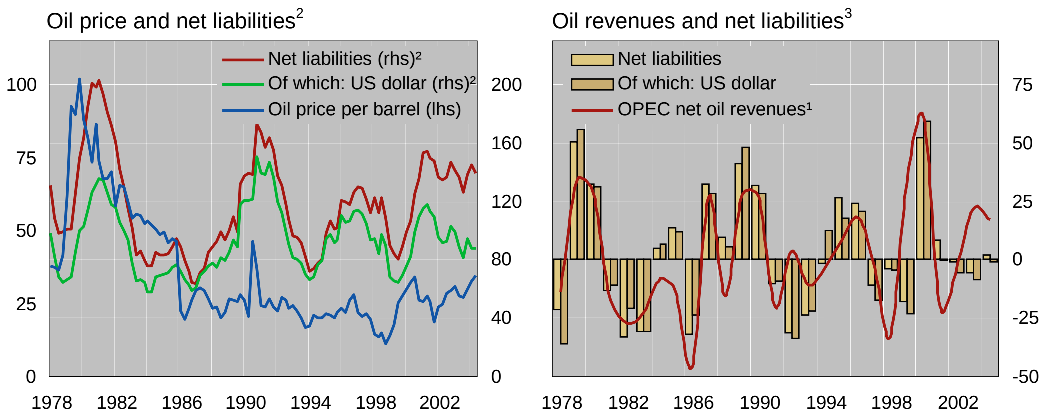
Oil prices and OPEC surpluses: a shift into euros?

While higher oil prices can play a role in boosting surpluses emanating from OPEC member countries, the recent rise in oil prices has had little if any significant impact on the stock of deposits placed abroad. However, there is some evidence suggesting that OPEC member countries are shifting the proportion of such deposits denominated in US dollars. In short, the co-movement between oil prices and OPEC dollar surpluses evident in previous periods seems to be less evident in the most recent cycle.

The historical relationship between oil prices and deposits abroad ...

Past experience suggests a rough, but discernible, relationship between oil prices, oil revenue and the net stock of funds placed by OPEC member countries with BIS reporting banks. Graph 2.8 (left-hand panel) shows that the real net stock of liabilities to OPEC member countries – a measure of their net funnelling of funds into the international banking system – has tended to rise with real oil prices, at times with a lag.[14] These countries placed (a portion of) oil revenues with banks abroad, subsequently drawing down these deposits during periods of slower revenue growth. This is highlighted in the right-hand panel of Graph 2.8, which shows that periods of high growth in the net stock of

Petrodollars and BIS reporting banks' positions vis-à-vis OPEC[1]



Note: Data are in real end-June 2004 US dollars, deflated by the US consumer price index.

[1] Excluding Indonesia. [2] Stock of liabilities minus claims of BIS reporting banks, in billions of US dollars. [3] Annual percentage changes, end-December figures. Data on net liabilities for 2004 are based on end-June figures. Oil revenues for 2004 are estimated.

Sources: US Department of Energy, Energy Information Administration (EIA); OPEC; BIS. Graph 2.8

[14] Indonesia is excluded from the list of OPEC member countries for this exercise.

liabilities vis-à-vis OPEC member countries moved in line with the growth in oil revenue flows. This relationship was most clear during the second oil shock in the late 1970s, and less so during the late 1980s, when large net placements of US dollars did not seem to be prompted by a correspondingly large jump in real oil prices. This may have reflected a flight to safety or investment in alternative assets rather than an amplified reaction to the relatively modest and short-lived spike in real oil prices around the first Gulf war.

... is less evident in the most recent cycle

The picture in the most recent cycle is considerably less clear. In real terms, oil prices reached levels in the second quarter not seen since their spike during the first Gulf war, although they were still substantially lower than their peak during the second oil shock of the late 1970s. Between the fourth quarter of 1998 and the third quarter of 2000, real oil prices rose by 207%.[15] This was accompanied, with a slight lag, by a near doubling in the real stock of net liabilities vis-à-vis OPEC member countries (Graph 2.8).[16] After falling by almost 50% between late 2000 and mid-2001, real oil prices have been on the increase again, up 85% since the fourth quarter of 2001. However, the net stock of funds placed abroad has not risen in this most recent cycle, as past experience would suggest. The real net stock of liabilities of BIS reporting banks vis-à-vis OPEC member countries has remained relatively flat since the second quarter of 2002, rising by only 3%. Moreover, the outstanding stock of real US dollar-denominated net liabilities actually decreased over this period, by 4%. Overall, this suggests that oil revenues have not been channelled into the international banking system in the most recent cycle, at least not to the extent that they were in previous periods.

OPEC deposits partially shift out of US dollars

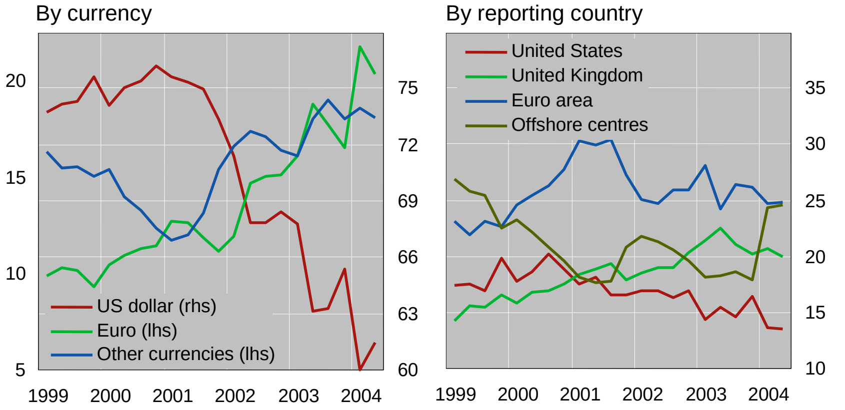
Despite these muted placements from OPEC member countries into BIS reporting banks, there has been a subtle but noticeable shift in the composition of deposits over the last three years. Since the third quarter of 2001, oil revenue seems to have been channelled increasingly into euro and other currency deposits. As shown in Graph 2.8, and highlighted in the left-hand panel of Graph 2.9, non-US dollar currencies account for an increasingly large share of the funds deposited by OPEC member countries with BIS reporting banks. US dollar-denominated deposits fell from 75% of total deposits in the third quarter of 2001 to 61.5% in the most recent quarter, while the share of euro-denominated deposits rose from 12% to 20% over this same period. This shift out of US dollars probably reflected to some extent the relative change in interest rates in the United States and the euro area since 1998. US dollar short-term interest rates were, on average, 2.1 percentage points higher than their euro equivalent between December 1998 and March 2001, but 1.3 percentage points lower, on average, between April 2001 and June 2004.

[15] Annual data from the US Energy Information Administration indicate that OPEC oil revenue increased from $126 billion in 1998 to $267 billion in 2000, a 113% increase. Oil revenue for 2004 is forecast to be $286 billion.

[16] The real net stock of liabilities vis-à-vis OPEC member countries rose by 91% between the third quarter of 1999 and the second quarter of 2000.

OPEC deposits with BIS reporting banks

In per cent



Graph 2.9

In the most recent quarter, when *nominal* oil prices hit an all-time high, BIS reporting banks' net liabilities vis-à-vis OPEC member countries actually fell (to $142 billion).[17] The drop from the previous quarter was the result of a $4.9 billion reduction in euro-denominated deposits held by banks in Saudi Arabia with banks in Germany, offshore centres and the United Kingdom. US dollar-denominated liabilities vis-à-vis OPEC member countries grew only modestly in the second quarter, by $2.8 billion, supported by increased deposits with BIS reporting banks from residents of Venezuela.

[17] The gross stock of liabilities vis-à-vis OPEC member countries (excluding Indonesia) fell to $253 billion in the second quarter.

Continued brisk activity in the market for international syndicated credits

Jesper Wormstrup

Activity in the market for international syndicated credits remained strong in the third quarter of 2004. Despite a drop from the previous quarter's record, the total volume of $430 billion implies an all-time high on a seasonally adjusted basis (see left-hand panel of graph below). As was the case in the previous quarter, refinancing deals – including prefinancing of facilities scheduled to mature at a later stage – reached a high level ($232 billion), reflecting the favourable financing conditions prevailing in the market. Facilities for mergers and acquisitions – including leveraged buyouts – jumped to $90 billion from a quarterly average of around $40 billion observed over the last three years. This increase was mainly attributable to companies in the health care, pharmaceuticals, telecommunications, and oil and gas sectors.

Albeit lower than the previous quarter's peak, signings by US entities remained fairly strong with a total volume of $206 billion. While the largest amounts were granted to the energy, health care and foodstuffs sectors, the largest individual deal was arranged by the machine and engine manufacturer Caterpillar Inc in the form of a $5 billion revolving credit. Non-investment grade borrowers (ie with a rating below BBB) secured an unusually high proportion of the total amounts obtained by all rated borrowers; over 40% compared with a historical average of around 20%.

In contrast to US signings, volumes for western European borrowers increased moderately from the previous quarter. Of a total of $150 billion, a remarkable $66 billion was accounted for by French entities. The government agency CADES signed a €20 billion short-term bridge facility/ revolving credit, the third largest deal ever in the market for international syndicated credits,[1] and the pharmaceutical company Sanofi-Synthélabo SA arranged a €16 billion deal for acquisition and refinancing purposes. Other large facilities secured by western European entities included refinancing deals by Deutsche Telekom AG (€5 billion) and Spanish telecommunications operator Auna Operadores de Telecomunicaciones SA (€4.5 billion).

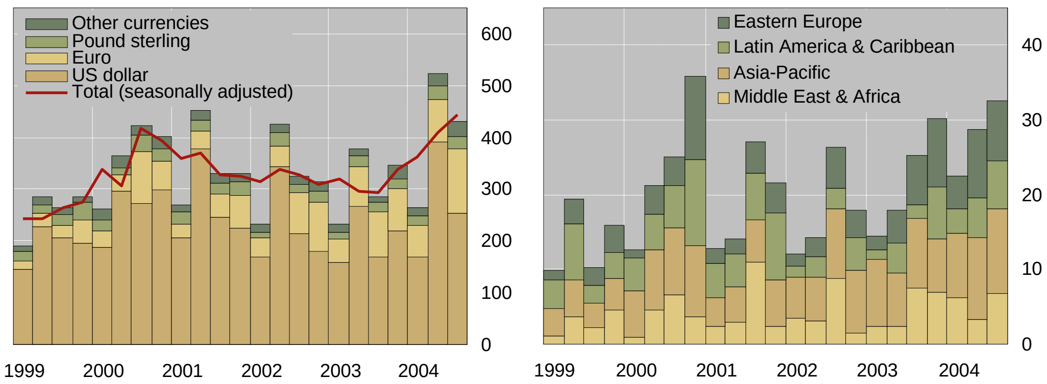
Lending to emerging market entities continued its upward trend in the third quarter of 2004 (see right-hand panel of graph below). At $32.5 billion in total, signings reached the highest level of any third quarter since 1997. In line with most recent quarters, Asian entities generated the most substantial volume ($11.3 billion), with large amounts going to the Taiwanese electronics and computer manufacturing sectors, and commercial banks in India, Korea and Kazakhstan.

Business in eastern Europe, totalling $7.9 billion, was primarily driven by Russian oil companies and metallurgical corporations. Turkish commercial banks also showed a marked presence, closing deals worth $2.2 billion at spreads up to 65 basis points lower than a year ago. Borrowing by entities in the Middle East and Africa region was supported by large signings by the Angolan national oil company Sonangol ($2.35 billion), the energy company Dolphin Energy Ltd of the United Arab Emirates ($1.36 billion) and the South African Reserve Bank ($1 billion). In Latin America, over half of the total volume of $6.5 billion was due to Mexican corporate sector borrowing, boosted by a $2.4 billion term loan signed by the telecommunications company Telmex, the largest emerging market deal in the third quarter.

Signings of international syndicated credit facilities

In billions of US dollars

Total signings by currency | Signings by emerging market entities



Sources: Dealogic Loanware; BIS.

[1] Cf the €30 billion deal by France Telecom in July 2002, and the $25 billion deal by AT&T Corp in December 2000.