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2. The international banking market

Investment in international debt securities by BIS reporting banks drove overall claim growth in the third quarter of 2004. Purchases of these instruments by banks in the United Kingdom and the euro area were particularly strong, while Japanese banks continued to invest in US and euro area government securities. By contrast, the growth in loans to non-bank borrowers was positive but weak, and largely reflected new lending to offshore centres.

Overall, emerging market economies experienced a relatively large net outflow of funds, driven primarily by growth in deposits placed with BIS reporting banks. Such placements contributed to an outflow of funds from Asia-Pacific and the Middle East and Africa. A reduction in claims, as well as deposit placements abroad, was behind a net outflow from Latin America. In emerging Europe, strong growth in claims on the countries that had recently entered the European Union drove a small net inflow, despite relatively substantial deposit placements abroad by certain countries.

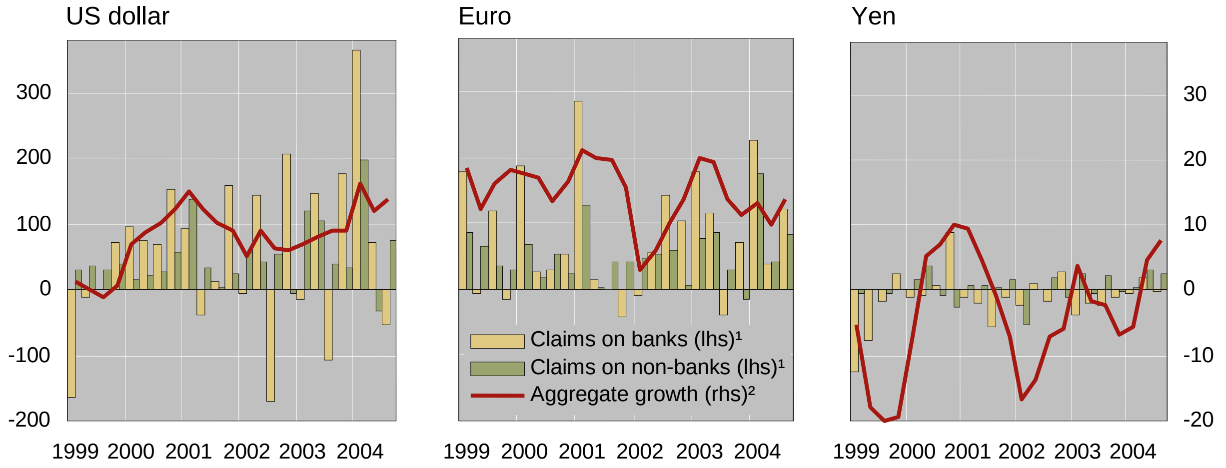
Purchases of international debt securities fuel claim growth

Investment in international debt securities drove the overall growth in claims in the third quarter of 2004. By contrast, the growth in loan claims remained weak. Overall, the total cross-border claims of BIS reporting banks rose by \$236 billion to \$17.7 trillion (Table 2.1). Over two thirds of the increase reflected purchases of government and other international debt securities, boosting claims on the non-bank sector in all three major currencies (Graph 2.1).

Loans to non-banks are subdued

What modest growth there was in loan claims was largely the result of greater lending to non-banks in offshore and other financial centres. Lending to such borrowers located elsewhere, particularly in the euro area and the United States, was subdued. Following an outright contraction in the previous quarter, loans to non-banks worldwide rose by a modest \$50 billion in the third quarter. Most of this flowed to borrowers in the United Kingdom and the Cayman Islands, areas with considerable non-bank financial activity. Loans to non-banks in the euro area actually contracted for the first time in two years (by \$32.6 billion). While a particularly large reduction in loans from banks in the United Kingdom to borrowers in Belgium and Luxembourg was a contributing

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

factor, loans to non-banks in almost every major euro area country also declined.

Banks in Japan and the euro area invest in debt securities

With long-term US dollar and euro yields continuing to fall in the third quarter, BIS reporting banks' claims were boosted by investment in international debt securities. While this was partially due to the continued purchase of US and euro area government bonds by Japanese banks, other banking systems, in particular banks in the United Kingdom, Ireland, Germany, France and the Netherlands, also made sizeable investments in these debt instruments. Overall, purchases of US dollar-denominated debt securities totalled \$50 billion, offsetting an overall decrease in US dollar loans. Euro-denominated debt security claims expanded by \$71 billion to \$2.3 trillion, or 34% of the total outstanding stock of euro-denominated claims.

Banks in Japan invest in debt securities ...

Banks in Japan increased international debt security claims the most, following a pattern evident since at least the first quarter of 2000. A relatively large reduction in interbank activity (\$16 billion) and in loans to borrowers in the United States and offshore centres was more than offset by a \$55 billion rise in international debt security claims. The BIS consolidated banking statistics, which consolidate worldwide positions, indicate that Japanese banks upped their exposure to the public sector by \$36 billion, primarily through the purchase of long-term debt issued by Germany and the United States. This pushed their total stock of outstanding claims on the public sector to \$434 billion, significantly higher than that of any other banking system.[1] Claims on the German public sector rose to 57% of their total international

[1] Japanese banks account for 26% of total consolidated international claims on the public sector of BIS reporting banks. German banks come in second at 17%.

claims on Germany, up from 53% in the previous quarter. Claims on the US public sector rose as well, to 47% from 46% in the previous quarter.

International debt security claims were further boosted by European banking systems. Banks in the United Kingdom increased debt security claims by $49 billion, primarily vis-à-vis non-banks in the United States and Germany. This seemed to be partially the result of banks located in the United Kingdom investing in US government securities; the BIS consolidated data indicate that UK banks' worldwide claims on the US public sector rose by $13 billion in the third quarter of 2004 to $23 billion. Banks in Germany also invested in international debt securities, much of which were issued by banks in the euro area, particularly in Ireland.

... as do banks in Ireland

Banks in Ireland invested in debt securities as well, a continuation of a trend evident since at least the second quarter of 2001. Starting from $64 billion at that time, total international debt security claims of these banks reached $220 billion in the third quarter of 2004, fifth behind banks in Japan, the United Kingdom, France and Germany (Graph 2.2). Over much of this time period, the BIS consolidated banking statistics, which provide a maturity

Cross-border claims of BIS reporting banks

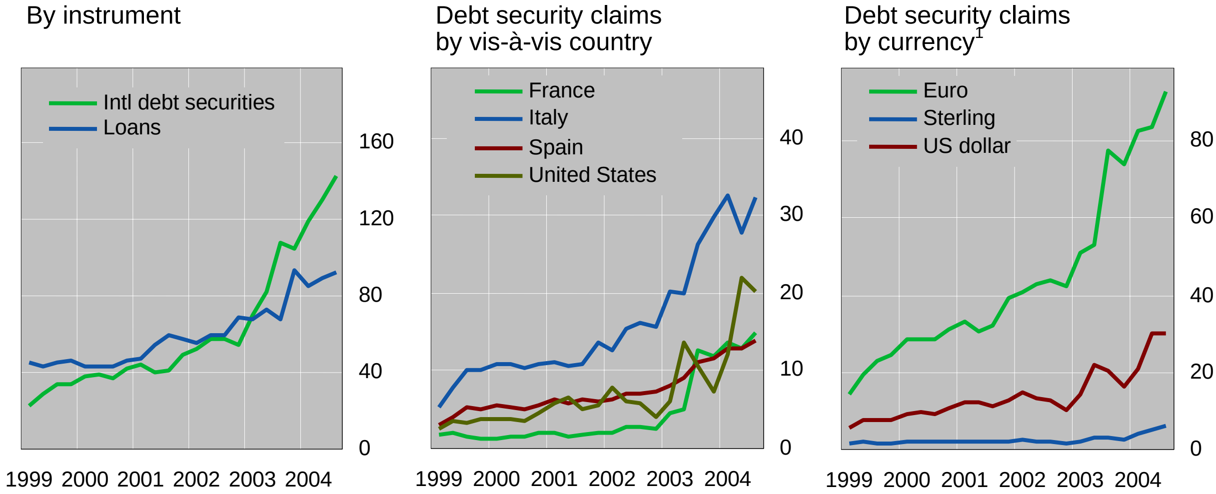
Exchange rate adjusted changes in amounts outstanding, in billions of US dollars[1]

	2002	2003	2003		2004			Stocks at end-Sep 2004
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Total cross-border claims	740.1	1,075.1	–110.0	315.8	1,231.7	240.2	236.1	17,706.8
on banks	425.0	530.1	–229.5	277.1	827.1	187.4	36.6	11,352.8
on non-banks	315.2	545.0	119.5	38.7	404.6	52.8	199.5	6,354.0
Loans: banks	395.1	452.0	–263.8	249.3	728.6	118.1	–5.3	9,605.4
non-banks	103.8	276.6	92.3	18.1	197.3	–20.2	50.0	3,238.1
Securities: banks	36.3	75.8	22.5	35.1	75.5	56.5	23.9	1,236.3
non-banks	202.2	208.3	8.3	6.5	190.1	32.1	136.8	2,740.6
Total claims by currency								
US dollar	320.4	500.0	–68.3	210.9	562.7	37.9	21.4	6,949.9
Euro	453.3	502.6	–8.0	53.9	400.4	83.7	201.6	6,728.5
Yen	–42.3	–50.6	0.7	–15.0	–1.9	49.3	25.9	827.0
Other currencies[2]	8.7	123.1	–34.4	66.0	270.5	69.3	–12.8	3,201.4
By residency of non-bank borrower								
Advanced economies	315.1	458.7	103.3	47.0	343.8	20.9	134.8	4,959.3
Euro area	117.4	157.4	50.5	–17.7	150.5	33.6	7.9	2,222.0
Japan	4.1	38.4	6.5	–5.2	0.1	20.5	14.7	212.0
United States	153.1	179.6	40.9	53.0	87.3	–32.9	48.6	1,615.8
Offshore centres	18.8	100.0	10.2	–10.1	41.6	33.6	62.0	767.4
Emerging economies	–16.5	5.0	4.9	3.1	23.9	1.6	–2.4	574.9
Unallocated[3]	–2.2	–18.7	1.1	–1.3	–4.7	–3.3	5.1	52.4
Memo: Local claims[4]	*44.5*	*415.0*	*51.7*	*94.1*	*187.0*	*34.8*	*–0.6*	*2,541.8*

[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

Banks in Ireland: claims on the non-bank sector

Amounts outstanding, in billions of US dollars



[1] At constant third quarter 2004 exchange rates. Graph 2.2

breakdown, indicate that Irish banks' share of long-term claims in their total international claims rose from 36% to 67%.[2] In the most recent quarter, international debt security claims of banks in Ireland were up by \$21 billion; roughly half of this represented investment in debt securities issued by non-banks in Italy, France, the United Kingdom and Greece.

Hedge fund activity in the Caribbean offshore centres

The quarterly swings in claims on non-bank borrowers in Caribbean offshore centres – an area with substantial non-bank financial activity – has become an important driver of the overall claim flows of BIS reporting banks.[3] Indeed, since the second quarter of 1996, the variance in the quarterly change in claims on the Caribbean offshore centres has been higher than that for any other single vis-à-vis country in the BIS statistics except the United States.[4] Loan flows to non-banks in the Cayman Islands, often from banks located in the United States, are by far the biggest factor behind these quarterly swings. In the third quarter of 2004, claims on these borrowers reached \$436 billion, third behind claims on non-banks in the United States and the United Kingdom. Yet very little is known about the nature of this financial activity. Many types of non-bank financial institutions – including hedge funds, insurance companies

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[2] The consolidated figures for Ireland are not available for the third quarter of 2004 since Ireland reports these statistics semiannually. Long-term claims are claims with a maturity of two years or more. Part of the rise in the share of these claims since the second quarter of 2001 is explained by a bank merger which caused a jump in this share from 35% of total international claims to 54% from the fourth quarter of 2001 to the second quarter of 2002.

[3] For the purposes of this exercise, Caribbean offshore centres include the Cayman Islands, the Bahamas, Bermuda, the British West Indies and the Netherlands Antilles.

[4] The variance in the exchange rate adjusted flows of claims on non-banks in the Cayman Islands ranks fourth behind that of claim flows vis-à-vis this sector in the United States, the United Kingdom and Japan.

and special purpose vehicles – are legally domiciled in the Cayman Islands, making interpretation of the quarterly movements in the BIS data difficult.[5]

Claims on the Cayman Islands ...

Considered over a longer horizon, it does appear that hedge fund activity has contributed directly to the overall growth in claims on the Cayman Islands. The left-hand panel of Graph 2.3 presents a comparison between the year-on-year growth in assets under management in a (limited) sample of hedge funds that are legally domiciled in the Cayman Islands, and that of the stock of outstanding claims on non-banks in the Cayman Islands.[6] While there have been deviations in these growth rates in the past (eg in 1997 and 2004), they do appear to move together over longer time periods. The collapse in both around the period of the Russian default and the near bankruptcy of the hedge fund Long-Term Capital Management (LTCM) in 1998 is particularly striking. This same pattern is evident around this period in other Caribbean offshore centres as well (Graph 2.4).[7]

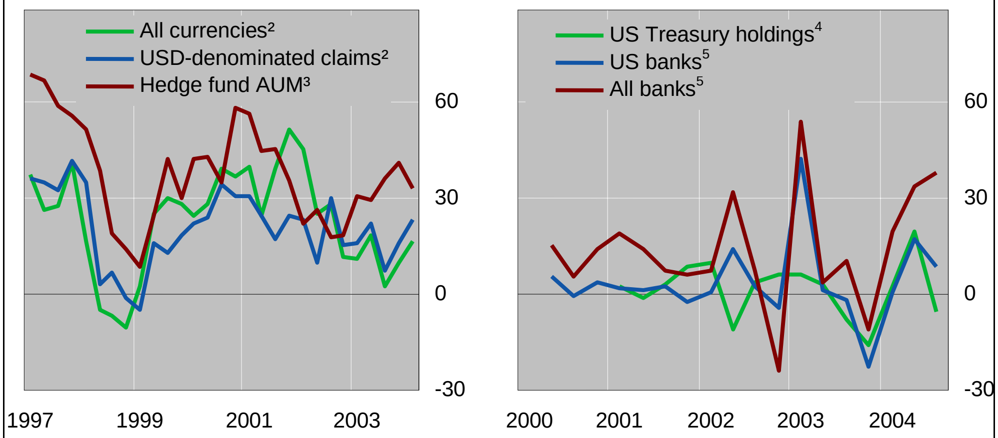
... seem to reflect hedge fund activity

The more recent quarterly swings in claims on the Cayman Islands seem to be at least broadly consistent with anecdotal evidence on hedge fund activity. Market participants have cited hedge funds as a driving factor behind the rise in purchases of US Treasury securities by residents of the Cayman

Activity vis-à-vis non-banks in the Cayman Islands

Bank claims and hedge fund assets under management (AUM)[1]

Bank claims and US Treasury holdings



[1] Annual growth, in per cent. [2] BIS reporting banks' claims on non-banks in the Cayman Islands. [3] Estimated for hedge funds legally domiciled in the Cayman Islands. [4] Change in outstanding stocks of US Treasuries held by entities registered in the Cayman Islands (source: TIC data). [5] Exchange rate adjusted claims of BIS reporting banks vis-à-vis non-banks in the Cayman Islands. US dollar-denominated claims only. Graph 2.3

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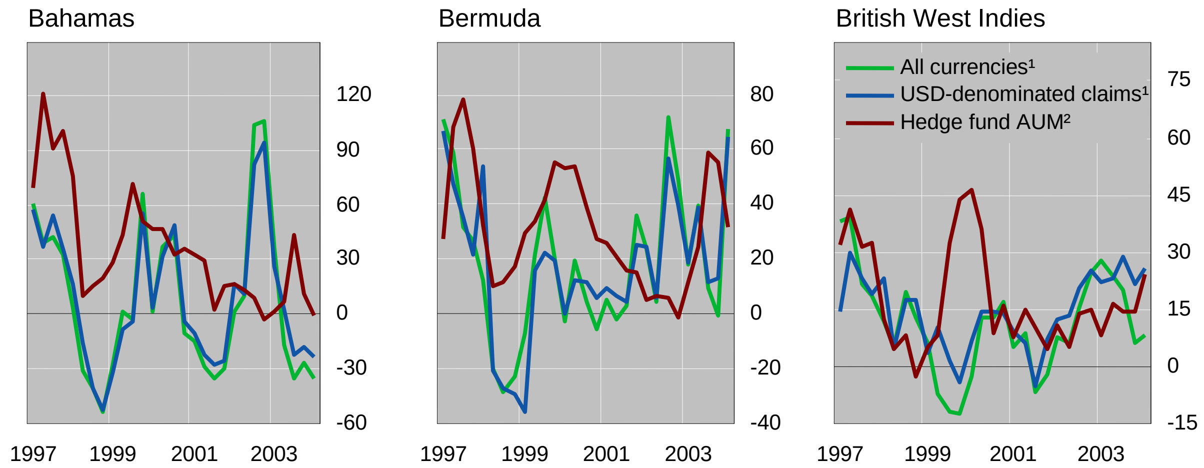
[5] See the Bank of England's June 2001 *Financial Stability Review* for a discussion of activity in offshore centres.

[6] The data on hedge funds is taken from the HFR database, which includes data on the assets under management and the legal domicile for a sample of approximately 900 individual hedge funds. Not all hedge funds that are legally domiciled in the Cayman Islands are included in this sample. A positive growth rate can reflect the addition of new funds to the database or growth in assets under management in existing funds.

[7] The co-movement in the growth rates of assets under management and BIS reporting banks' claims on the non-bank sector in these other centres seems to break down after 1999.

Activity vis-à-vis non-banks in Caribbean offshore centres

Annual growth, in per cent



[1] BIS reporting banks' claims on non-banks. [2] Estimated growth in assets under management of hedge funds legally domiciled in these offshore centres.

Graph 2.4

Islands in 2004.[8] Such investment can be linked with BIS reporting banks' claims, at least to the extent that hedge funds finance these purchases through bank borrowing. As shown in the right-hand panel of Graph 2.3, the increase in claims on non-banks in the Cayman Islands over the course of 2004 seems to have roughly corresponded to purchases of US Treasuries by entities registered there.

Deposit growth drives outflow from emerging market economies

A net outflow from emerging market economies in the third quarter, the largest in four years, resulted from relatively large placements of deposits in BIS reporting banks. Banks in the Middle East and Africa, Asia-Pacific and emerging Europe contributed to a combined $50 billion increase in deposit liabilities vis-à-vis emerging markets. In emerging Europe, this was primarily due to new deposits placed by banks in Russia, the fifth consecutive quarterly rise. An increase in US dollar-denominated deposits by banks in Saudi Arabia drove the net outflow from the Middle East and Africa, while deposit placements by banks in several countries in Asia-Pacific, in particular Korea, India and Taiwan (China),[9] were responsible for the net outflow there. On net, funds flowed out of Latin America for the 10th consecutive quarter, this time as a result of reduced credit to all sectors.

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[8] See "Treasury Islands", *Bloomberg Markets*, February 2005. Investment in US Treasury bonds by residents in the Caribbean has made the region the fourth largest holder of US government debt behind Japan, China and the United Kingdom.

[9] Hereinafter Taiwan.

New claims on EU accession countries outpace Russia's deposit placements

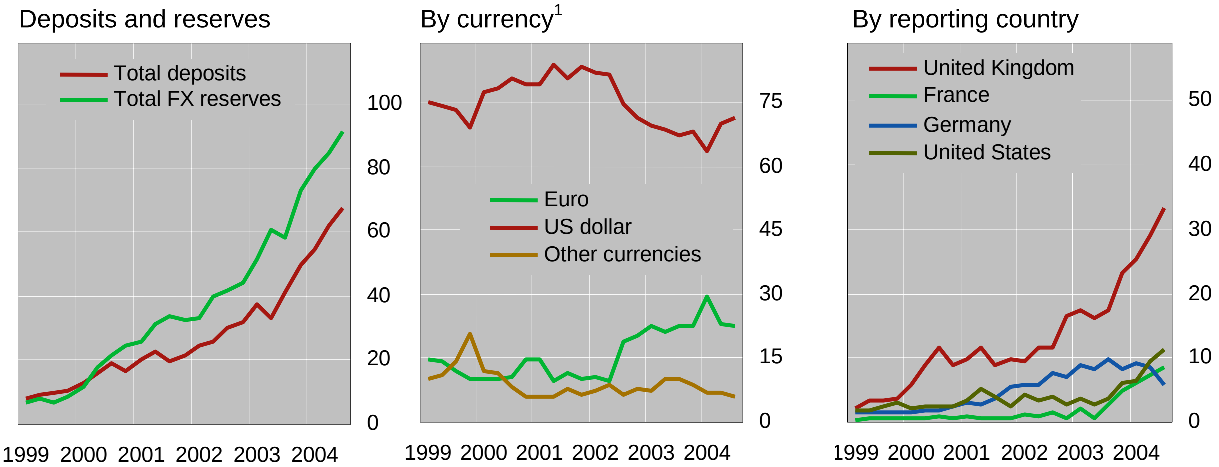
A net inflow to emerging Europe ...

New credit to borrowers in emerging Europe was strong, and led to a relatively small net inflow of funds into the region of $1.7 billion. Total claims on the region rose by $8.4 billion, virtually all flowing to borrowers in the countries that had recently joined the European Union. While much of this reflected interbank activity, BIS reporting banks' investment in international debt securities issued by non-banks in these countries contributed as well. Elsewhere, a fifth consecutive quarterly increase in deposits placed abroad by banks in Russia partially offset the overall rise in claims.

The continued placement of deposits in BIS reporting banks by banks resident in Russia has gone hand in hand with the accumulation of foreign exchange reserves by the Russian monetary authority.[10] These reserves increased by $6.9 billion in the third quarter of 2004 to $91 billion (Graph 2.5, left-hand panel).[11] At the same time, banks in Russia deposited $5.7 billion, mainly in US dollars, with banks in the United Kingdom, the United States and France. Until mid-2002, US dollars accounted for over 80% of deposit liabilities vis-à-vis banks in Russia (Graph 2.5, centre panel).[12] This share gradually fell to 64% by the first quarter of 2004 while, over this same time period, the share of euro-denominated deposits rose from 8% to 29%. Over the last two quarters,

Deposit liabilities vis-à-vis banks in Russia

Amounts outstanding, in billions of US dollars



[1] Shares in per cent, based on constant third quarter 2004 exchange rates; in currency reporting countries. Graph 2.5

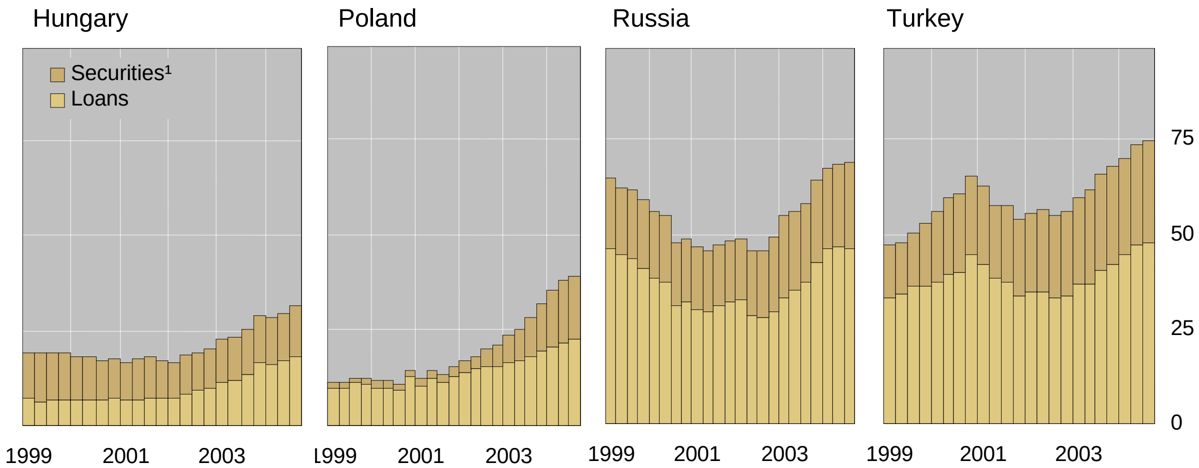
[10] Liabilities vis-à-vis banks include those vis-à-vis central banks. While data from the IMF indicate that Russia's foreign exchange reserves have been on the rise, they provide no information on the actual share of these reserves held as deposits in banks outside of Russia. See the banking chapter of the September 2004 *BIS Quarterly Review* for a discussion of the link between BIS reporting banks' liabilities vis-à-vis banks and foreign exchange reserves.

[11] Russia now accounts for 33% of the region's reserves, from 18% in the third quarter of 2000.

[12] The currency shares are calculated using data that have been partially corrected for valuation effects. The stocks of euro, yen, pound sterling and Swiss franc liabilities are converted to US dollars using constant third quarter 2004 exchange rates.

International financing for selected emerging European countries

Amounts outstanding, in billions of US dollars



[1] The amounts outstanding of securities are calculated based on issuance, repayments (scheduled and unscheduled) and amortisation.

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Graph 2.6

the deposit placements by banks in Russia have been primarily US dollar-denominated, driving the currency's share of total deposit liabilities vis-à-vis banks in Russia back up to 71.5%.

... is driven by loans to recent EU accession countries

Elsewhere in the region, the growth in claims remained strong, particularly vis-à-vis the countries which had recently joined the European Union. The expansion in claims on all sectors in these countries has been evident since at least 2002. Between the fourth quarter of 1999 and the second quarter of 2002, the year-over-year growth in claims on banks in the recent accession countries was 9%. This average growth rate has jumped to 22% since the second quarter of 2002. Similarly, the corresponding growth in claims on non-banks in these countries rose from 13% to 17% across these time periods. In the most recent quarter, new lending to banks in Poland, Malta, Slovakia and Hungary drove the $8.4 billion rise in total claims on the accession countries, although new lending to non-banks in Cyprus and, to a lesser extent, Hungary was noteworthy as well.

Over the longer term, loans from BIS reporting banks have continued to outpace issuance of international debt securities by borrowers in some emerging European countries (Graph 2.6).[13] Indeed, even as the outstanding stock of loans has continued to grow, the stock of outstanding international bonds issued by borrowers in Russia and Hungary has not changed significantly since 1999. Even so, for some countries in the region at least, this picture can be misleading if interpreted as an indication of the relative importance of securities investment in the region. Local bond markets are large

[13] This is in contrast to the cross-border financing picture for the major borrowing countries in Latin America. See the banking chapter of the December 2004 *BIS Quarterly Review* for a discussion.

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-Sep 2004
		Year	Year	Q3	Q4	Q1	Q2	Q3	
Total[2]	Claims	–37.0	64.9	20.6	14.7	67.9	26.6	–2.4	1,105.4
	Liabilities	–45.9	72.1	28.2	43.1	107.2	21.3	47.5	1,397.1
Argentina	Claims	–11.8	–8.5	–5.4	–2.1	–2.6	–1.1	–1.3	18.7
	Liabilities	0.0	–0.8	–2.2	0.7	0.3	0.1	–0.1	25.2
Brazil	Claims	–11.2	–7.2	1.4	–9.1	1.8	–4.0	–2.9	78.4
	Liabilities	–8.0	14.4	7.9	–3.4	5.0	–3.6	–7.0	51.1
China	Claims	–12.4	13.5	4.9	–1.0	13.9	10.1	–3.1	81.6
	Liabilities	–3.6	–6.4	1.8	1.8	21.6	20.5	–1.7	129.0
Czech Rep	Claims	2.3	3.7	0.8	1.7	–1.7	0.8	0.4	19.5
	Liabilities	–3.7	–2.4	0.2	–0.9	–2.6	2.5	–0.6	9.3
Indonesia	Claims	–6.0	–4.6	–1.9	–0.8	0.3	–0.9	0.4	28.5
	Liabilities	–2.4	0.2	–0.5	0.3	–0.2	–2.1	–0.2	33.7
Korea	Claims	8.2	–1.0	–1.5	0.1	14.3	–8.5	0.8	83.4
	Liabilities	0.5	7.3	2.1	12.1	21.7	–4.8	2.9	59.5
Mexico	Claims	3.1	–0.8	0.8	–0.9	7.5	–0.6	–8.1	63.8
	Liabilities	–11.4	6.2	–0.3	–0.1	4.0	–0.7	–5.5	59.9
Poland	Claims	2.9	3.3	1.0	0.4	2.4	2.0	1.5	39.1
	Liabilities	–3.1	–0.1	–1.0	1.2	3.0	3.9	–0.2	25.5
Russia	Claims	3.6	12.1	2.8	5.8	3.4	–0.3	–1.9	53.4
	Liabilities	9.6	16.2	7.2	7.9	5.0	7.8	5.5	76.1
South Africa	Claims	–0.4	–1.2	–0.9	–0.7	–0.1	0.5	–0.3	18.6
	Liabilities	2.7	9.7	1.4	2.8	3.9	1.6	0.7	38.3
Thailand	Claims	–5.0	–1.6	0.0	–1.6	–1.0	–0.4	1.7	19.1
	Liabilities	–4.6	5.7	0.9	3.2	–1.5	–0.8	1.7	28.2
Turkey	Claims	–2.8	5.3	3.4	0.1	4.1	3.4	0.0	51.7
	Liabilities	0.0	–0.4	1.0	0.9	2.9	0.9	1.1	25.2
Memo:									
New EU countries[3]	*Claims*	*9.2*	*20.9*	*5.6*	*8.5*	*3.9*	*6.6*	*8.4*	*139.0*
	Liabilities	*–5.9*	*–0.4*	*2.0*	*0.8*	*3.2*	*4.8*	*0.1*	*69.6*
OPEC members	*Claims*	*–9.9*	*–6.5*	*–1.9*	*2.0*	*9.2*	*1.8*	*5.2*	*145.8*
	Liabilities	*–8.8*	*–15.1*	*–10.2*	*12.2*	*16.5*	*–2.4*	*24.8*	*312.9*

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

Table 2.2

and well developed in many emerging European countries, and foreign investment in these markets, which is not captured in the BIS international debt securities data, has been substantial. Much of this investment has been concentrated in countries that are expected to join the euro area in the future, as investors take positions in anticipation of a convergence in interest rates once these countries adopt the euro as their domestic currency.

BIS reporting banks invest in local bond markets

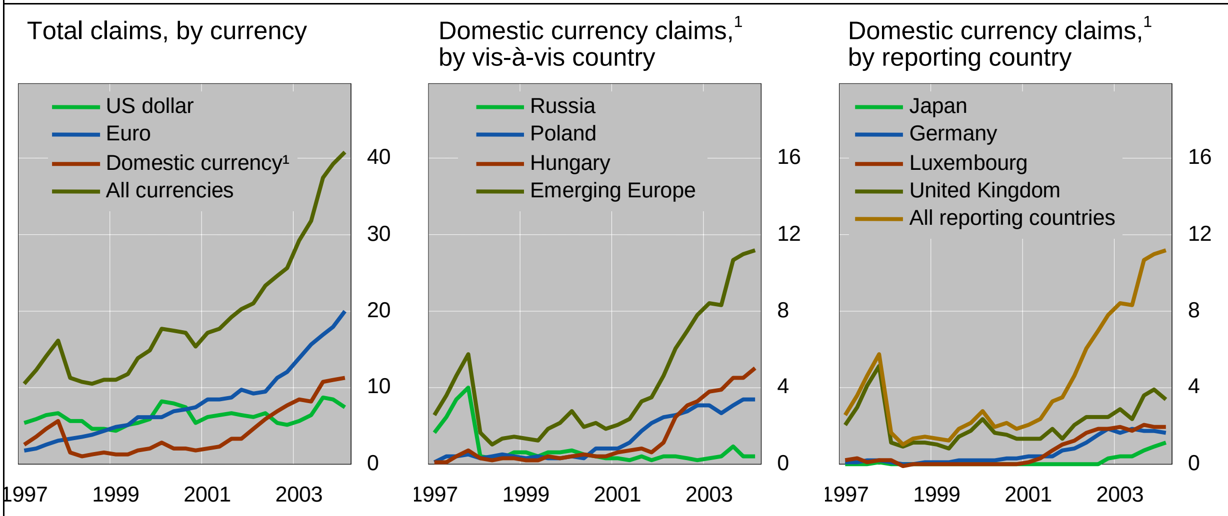
The BIS banking data, which include international debt securities held by reporting banks, seem to support this hypothesis. International debt security claims of BIS reporting banks on the non-bank sector in countries that recently joined the European Union accounted for 43% of total claims on this sector (region-wide) in the third quarter, up from 39% a year earlier and 33% two years ago. While much of this rise reflected purchases of euro-denominated international bonds issued by governments and corporates in these countries, a significant portion included purchases of domestic currency bonds issued by these same entities (Graph 2.7).[14] In particular, investment by BIS reporting banks in local currency denominated debt securities in Poland and Hungary has risen sharply since the first quarter of 2001. Banks in the United Kingdom have long been invested in these securities; the sharp spike in 1998 reflected investment in local currency bonds issued by borrowers in Russia, and the subsequent decline in these positions following the Russian default (Graph 2.7, centre and right-hand panels). More recently, banks in the United Kingdom have increased their exposure to bond markets in Poland and Hungary, followed by banks in Germany, Luxembourg and Japan.

Loan writedowns contribute to outflow from Latin America

While the outstanding stock of claims on several of the region's largest borrowing countries continued to fall, the net outflow of funds from Latin America was primarily the result of reduced claims on Mexico. Much of this was due to a one-off transaction: the acquisition by a subsidiary of a large international bank of the equity stakes of minority shareholders explained about half of the $8.1 billion drop in claims on the country. Excluding this transaction, the fall in claims on the region as a whole reflected reduced credit to all sectors in Brazil, and the continuing writedown of loans vis-à-vis borrowers in Argentina.

Debt security claims on non-banks in emerging Europe

Amounts outstanding, in billions of US dollars



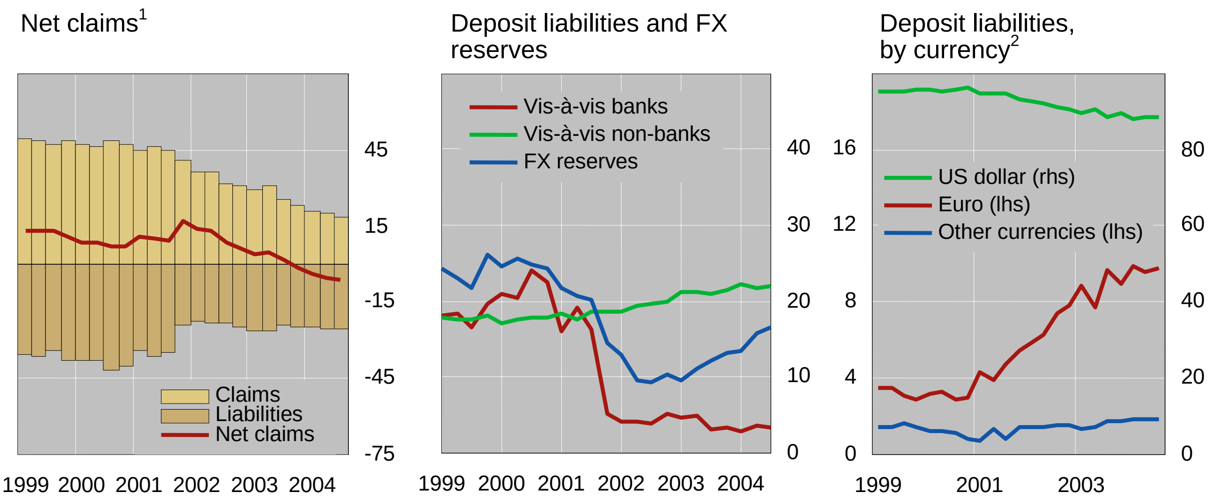
[1] Domestic currency of the vis-à-vis country. Estimated as the residual foreign currency claims of all BIS reporting banks.

Graph 2.7

[14] This can be seen in the rising stock of "residual other foreign currency claims", which are international debt security claims denominated in a currency other than the five major currencies. This is likely to consist mostly of bonds issued in the domestic currency of the vis-à-vis country.

Positions vis-à-vis Argentina

In billions of US dollars



[1] Claims minus liabilities. [2] As a share of total deposit liabilities in currency reporting countries, at constant third quarter 2004 exchange rates.

Graph 2.8

Banks reduce claims on Mexico and Brazil ...

After Mexico, claims on Brazil fell the most. Banks in offshore centres reduced interbank activity with banks in Brazil, while banks in the United States, the United Kingdom and the euro area reduced credit to the non-bank sector. The reduction in claims on banks occurred even as financial institutions in Brazil returned to the capital markets, with net issues of $1.2 billion in the third quarter. BIS reporting banks' total claims on Brazil fell by $2.9 billion to $78.4 billion, from $81.2 billion in the previous quarter and $91 billion a year earlier. Despite this drop, Brazil experienced a relatively large net inflow of funds, as banks located there repatriated $5.7 billion in deposits placed in banks abroad. Non-banks in Brazil repatriated an additional $2 billion.

... as well as on Argentina

Even as claims on Argentina continued to fall, increased deposits placed abroad by non-banks in the country have made it a net creditor to the international banking system (Graph 2.8). The continued writedown of loans vis-à-vis Argentina has pushed down the stock of BIS reporting claims on the country to $18.7 billion, from $20 billion in the previous quarter and $25.3 billion a year earlier. The net debt to BIS reporting banks of the Argentine banking sector fell from $8.9 billion in the second quarter of 2002 to $1.3 billion in the most recent quarter. Concurrent with this, BIS reporting banks' liabilities vis-à-vis Argentina have trended upwards, reflecting greater deposit placements by non-banks in banks in the United States, Switzerland and the euro area. Total liabilities vis-à-vis this sector have hovered near $21 billion since the first quarter of 2003, up from an average of $19 billion in 2002.

Deposit placements drive outflow from Asia-Pacific

Asia-Pacific experienced a large net outflow of funds, as both banks and non-banks in the region deposited funds with banks abroad. These deposit placements, coupled with a small reduction in claims on the region, yielded a

$15 billion net outflow overall. For some countries, the placements by banks coincided with increases in foreign exchange reserves held by the monetary authorities in these countries.[15]

The reduction in claims on the region was primarily the result of reduced credit to banks in China. After having trended upwards since the fourth quarter of 2002, claims of BIS reporting banks on the Chinese banking sector fell by $3.1 billion, reflecting reduced loans from banks in offshore centres and Japan. This reversal in the rise in claims on this sector may have been a reaction to new regulations adopted in the third quarter designed to curb the capital inflow that is contributing to official foreign exchange growth. In July 2004, restrictions on cross-border borrowing of foreign currency were extended to foreign banks operating in China. These had theretofore been less constrained than Chinese banks in borrowing foreign currency offshore to fund loans to corporate clients in China.

Deposits placed by banks in Asia-Pacific ...

Rather than movements in claims, a rise in deposits placed with BIS reporting banks was behind the net outflow from Asia-Pacific in the most recent quarter. Total liabilities of BIS reporting banks vis-à-vis the region rose by $13.3 billion. In particular, deposit placements accounted for a fifth consecutive net outflow from Korea. In a quarter in which foreign exchange reserves held by the Korean central bank grew by $7.4 billion, banks in Korea deposited $3.7 billion in BIS reporting banks, pushing their total deposits to $50.5 billion.[16] Banks in other countries also deposited funds abroad. These placements, coupled with a reduction in claims, contributed to a net outflow from Taiwan, the largest in the region. Banks in Taiwan placed $2.7 billion (primarily US dollar-denominated) with banks in offshore centres, and an additional $1.8 billion in banks in the United Kingdom. Deposit liabilities vis-à-vis banks in Malaysia and India also grew.

... have risen over the past year

The moves in the most recent quarter seem to be a continuation of the strong growth in deposit liabilities vis-à-vis banks in Asia-Pacific. From the second quarter of 2003 to the third quarter of 2004, BIS reporting banks' deposit liabilities vis-à-vis banks in the region grew by $157.5 billion to $350.4 billion. Much of this reflected placements abroad by banks located in China, Korea, India and Taiwan. The majority of these funds were deposited in offshore centres, as well as in banks in the United Kingdom, the euro area and Japan.

While it is difficult to precisely track the currency composition of these placements, the BIS banking statistics provide some tentative evidence that the deposits placed abroad by banks in the region have been increasingly denominated in currencies other than the US dollar (Graph 2.9). Admittedly,

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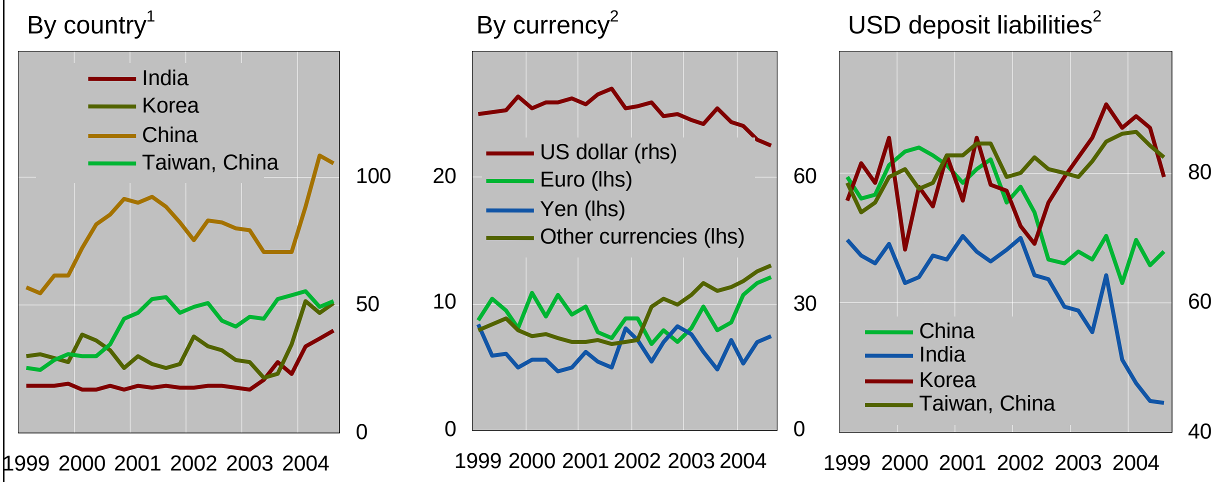
[15] Total foreign exchange reserves held in the region grew by $56.5 billion. Much of the growth was accounted for by China, although Korean, Malaysian and Indonesian foreign exchange reserves grew as well.

[16] While US dollar-denominated deposits make up the bulk of total deposits placed (in currency reporting countries) by banks in Korea, the placements in the most recent quarter were primarily euro- and yen-denominated. Korea now accounts for 14% of the region's total foreign exchange reserves.

Deposit liabilities vis-à-vis banks in Asia Pacific



[1] In billions of US dollars in all reporting countries. [2] As a share of total deposit liabilities placed in currency reporting countries, at constant third quarter 2004 exchange rates.

Graph 2.9

this data should be interpreted with caution because as much as 42% of the total stock of liabilities vis-à-vis banks in the region are deposited in BIS reporting countries that do not provide a currency breakdown, in particular Singapore and Hong Kong SAR.[17] Furthermore, the deposits placed in BIS reporting banks will not capture currency exposure through the off-balance sheet positions of the region's banking sector.

Even so, the data from the countries that do report a currency breakdown indicate a fall in the share of US dollar-denominated deposits placed in reporting banks, from 81% in the third quarter of 2001 to 67% in the third quarter of 2004.[18] This shift was most evident for banks in India, which place almost 90% of their deposits in currency reporting countries and account for 11% of the total deposit liabilities (of all BIS reporting banks) vis-à-vis banks in the region. The share of their US dollar-denominated deposits fell from 68% of total deposits placed in currency reporting countries in the third quarter of 2001 to 43% in the most recent quarter. The corresponding share for banks in China fell from 83% to 68% over this same period; this share declined until the third quarter of 2002, but has fluctuated around 68% since (Graph 2.9, right-hand panel).

Does this signal a more general shift away from dollar exposure by the region as a whole? The evidence on this question is far from conclusive. US dollar-denominated deposits placed (in currency reporting countries) by banks in the region continue to rise in absolute terms, suggesting, at most, that the currency shift described above is taking place at the margin. Furthermore, residents in the region continue to invest in US Treasury securities; the TIC

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[17] In the third quarter of 2004, 50% of the deposits in BIS reporting banks placed by banks in China were in currency reporting countries. The corresponding figures for India, Korea and Taiwan were 85%, 57% and 63% respectively.

[18] The currency shares are calculated using data that have been partially corrected for valuation effects. The stocks of euro, yen, pound sterling and Swiss franc liabilities are converted to US dollars using constant third quarter 2004 exchange rates.

data indicate that the combined holdings of US Treasuries by residents in China, Taiwan, Korea, Thailand and India increased by $52.4 billion between end-June 2003 and end-September 2004. Moreover, while the above figures are suggestive of such a shift away from US dollar exposure for the region's banking sector, the same phenomenon has not been evident in the non-bank sector. Deposit liabilities (of all BIS reporting banks) to non-banks in the region have fallen over the last year to $148.6 billion, or 23% of all deposit liabilities vis-à-vis the region (from 40% a year earlier). Since the third quarter of 2001, the share of US dollar-denominated deposits in total deposits (placed in currency reporting countries) by these borrowers has remained roughly constant, sitting at 72% in the most recent quarter.[19] While this share seems to have been declining for non-bank borrowers in India, it has, if anything, risen slightly for those in China.

[19] The deposit liabilities of BIS reporting countries vis-à-vis non-banks in Asia-Pacific that provide a currency breakdown account for only 55% of the total deposit liabilities of all BIS reporting countries vis-à-vis the sector.

Refinancing boosts syndicated lending to record levels

Blaise Gadanecz

In the fourth quarter of 2004, signings of international syndicated loans reached their highest level since the BIS began compiling statistics on this market segment. Signings of new facilities totalled \$564 billion, bringing the volume for 2004 as a whole to a record high of \$1.8 trillion. Refinancing and merger financing boosted business. On a seasonally adjusted basis, signings have been trending up steadily since the second half of 2003.

Banks contributed a generous supply of new credits to borrowers from industrial countries. Spreads remained low by historical standards – especially on US refinancings – while average maturities rose, and a slightly lower proportion of loans carried collateral or covenants. US and western European borrowers secured record amounts for refinancing and M&A purposes (the LBO segment was exceptionally active: see the Overview on page 1). In the United States, the energy, telecoms and health care sectors were most active. Oracle and BellSouth Corp arranged the biggest amounts (\$9.5 billion and \$9 billion respectively, both for acquisition purposes). In western Europe, the lion's share of new lending was directed to the energy, automobile and retail sectors. The energy firm E.ON AG obtained the largest loan, rolling over €10 billion.

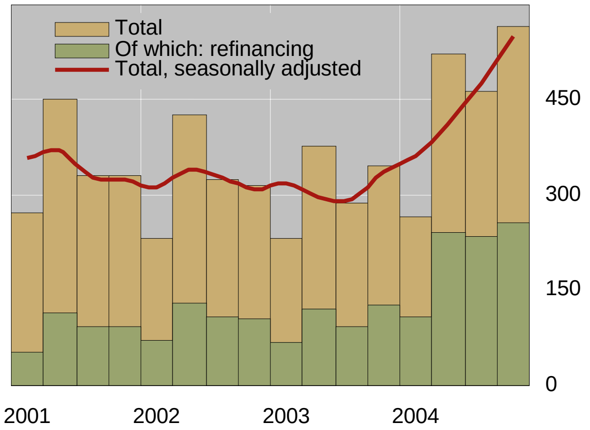
While supply conditions were favourable towards the end of the year, borrowers appear to have opted, in recent quarters, for a somewhat higher proportion of so-called club deals. These are loans syndicated to a small number of relationship banks, rather than being offered to a wider circle of financial institutions. This may have reflected a desire on the part of borrowers to work with smaller groups of lenders that are easier both to manage and to reward with higher-yielding ancillary business, such as treasury management or investment banking services.

Lending to emerging markets reached a peak not seen since the end of 1997. Borrowers from eastern Europe experienced a reduction in spreads and obtained the highest amounts – almost a third of the total amount of \$41.3 billion granted to emerging markets. Activity in the region was driven by Russian and Turkish banks as well as the Russian energy industry.[①] Lending to Asian and Latin American borrowers was also buoyant. While new funding for Asia was dispersed among a large number of countries, it was more concentrated for Latin America, where Mexican borrowers were most active. The cement and construction materials manufacturer CEMEX SA de CV raised \$5.3 billion, a large part of it through European acquisition vehicles, with a view to buying a cement manufacturer in the United Kingdom.

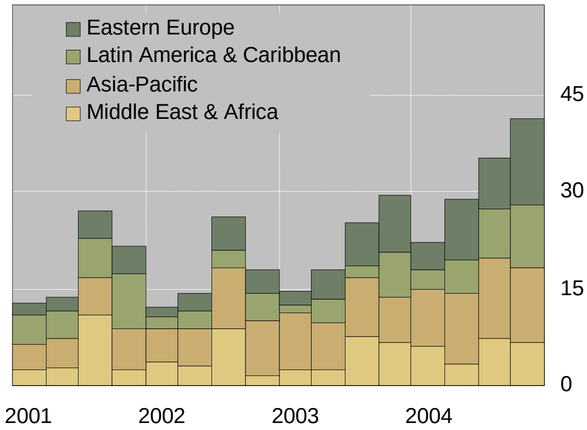
Signings of international syndicated credit facilities

In billions of US dollars

Total signings



Signings by emerging market entities



Sources: Dealogic Loanware; BIS.

① Not included in these amounts is a \$10 billion loan – subsequently called off – that Gazprom had started to arrange in December for the acquisition of Yukos.