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2. The international banking market

Claims surged in the first quarter of 2005. Interbank lending in the euro segment of the market, as well as credit to non-banks in the United States, rose noticeably. In addition, BIS reporting banks continued to channel funds to non-banks in the United Kingdom and offshore centres, areas with considerable non-bank financial activity. Lending to these non-bank borrowers has contributed significantly to overall claim flows in recent quarters, accounting for 40% of the overall rise in loans to the non-bank sector worldwide since end-2002. While banks' aggregate positions vis-à-vis offshore centres capture numerous types of financial activity – which are difficult to disentangle – there is some evidence that hedge funds may have contributed to the rise in loans to non-banks in some areas.

Emerging markets experienced a relatively large net inflow of funds, the result of increased cross-border credit to banks in Asia-Pacific. Large quarterly net inflows to the region have occurred with some regularity since 2001, despite the growing current account surpluses in many countries. In Latin America, placements of deposits abroad outpaced a rise in claims and led to a net outflow. Elsewhere, banks in Russia drove a net outflow from emerging Europe, despite strong growth in claims on borrowers in the new EU member countries. Since 2002, the stock of BIS reporting banks' net claims on Latin America and emerging Europe has tracked the current account balances of countries in these regions.

Foreign-headquartered banks have an expanding presence in many emerging markets. Measures of foreign bank participation in domestic banking markets indicate that the share of total bank credit accounted for by foreign-headquartered banks has risen since 1995 in Latin America and emerging Europe. In comparison, that share has remained low in Asia-Pacific.

Interbank activity drives claim growth in the first quarter

Cross-border claims surged in the first quarter of 2005, largely the result of greater interbank activity in the euro segment of the market, and of increased claims on non-bank borrowers in the United States and offshore centres. Total claims rose by $1.0 trillion to $19.8 trillion in the first quarter of 2005 (Table 2.1), the second largest quarterly increase since the BIS statistics have been collected. The largest quarterly expansion had occurred in 2004, and thus

Cross-border claims of BIS reporting banks

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

	2003	2004	2004				2005	Stocks at end-Mar 2005
	Year	Year	Q1	Q2	Q3	Q4	Q1	
Total cross-border claims	1,076.7	2,262.0	1,228.8	240.0	227.2	565.9	1,040.1	19,792.6
on banks	530.6	1,344.7	819.8	191.3	–5.4	339.1	602.1	12,552.8
on non-banks	546.1	917.3	409.0	48.8	232.6	226.8	438.0	7,239.8
of which Loans: banks	453.4	911.0	607.5	130.1	–105.4	278.8	372.1	10,605.1
non-banks	277.9	439.3	271.9	–25.8	57.5	135.7	261.8	3,740.7
of which Securities: banks	75.6	265.6	190.8	51.0	–11.1	35.0	112.8	1,378.5
non-banks	208.5	362.1	118.5	33.5	162.8	47.3	113.0	3,004.5
Total claims by currency								
US dollar	580.7	1,113.1	618.8	61.5	9.6	423.1	267.0	8,315.5
Euro	502.7	808.4	400.1	81.0	202.4	125.0	584.6	7,884.8
Yen	–127.2	96.3	–21.5	50.7	36.8	30.2	–29.8	1,059.3
Other currencies[2]	120.5	244.2	231.4	46.8	–21.6	–12.4	218.2	2,533.1
By residency of non-bank borrower								
Advanced economies	452.3	673.8	362.0	29.6	131.1	151.1	371.0	5,628.4
Euro area	157.6	239.3	151.1	33.2	11.0	44.1	110.8	2,476.3
Japan	38.4	73.3	0.1	21.4	15.6	36.3	–32.8	230.3
United States	172.5	164.6	105.1	–25.1	38.9	45.7	207.0	1,871.5
Offshore centres	100.0	238.8	41.6	33.8	106.0	57.4	55.8	936.9
Emerging economies	6.1	50.4	24.5	2.3	1.2	22.4	17.8	625.9
Unallocated[3]	–13.5	–40.7	–15.8	–14.3	–6.2	–4.3	–6.9	20.2
Memo: Local claims[4]	*415.1*	*221.0*	*188.6*	*34.2*	*3.2*	*–5.0*	*231.2*	*2,919.0*

[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

the year-on-year growth in claims actually fell to 12% in the first quarter of 2005 from 14% in the previous one.

Euro-denominated interbank activity swells

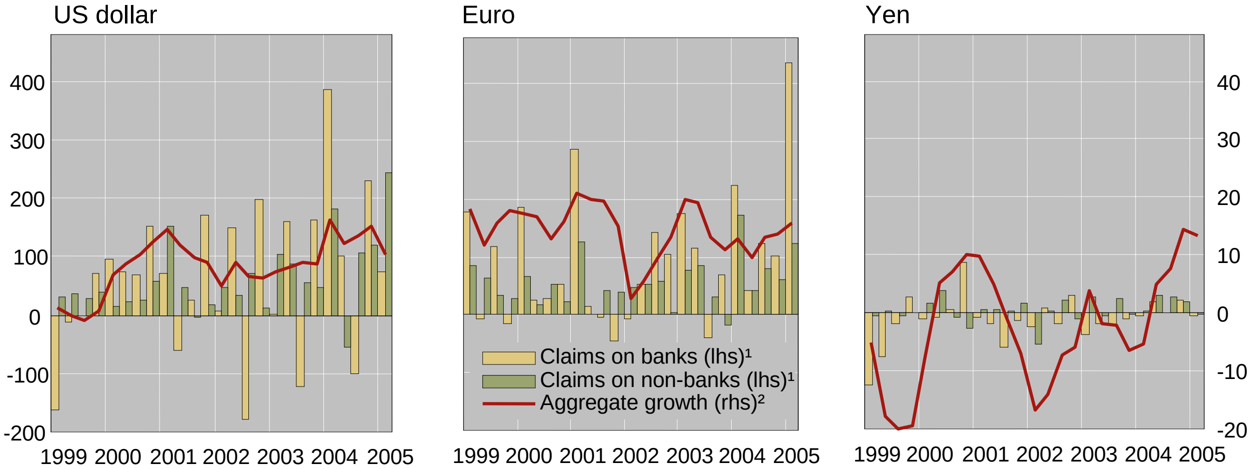
Interbank activity accounted for over half of this quarterly rise in total claims. Worldwide, claims on banks increased by $602 billion, with particularly strong growth in the euro segment of the market (Graph 2.1). Euro-denominated claims rose by $467 billion, the result of greater lending to banks in the euro area and the United Kingdom. Inter-office activity accounted for a portion of this; German, Dutch and French banks all transferred funds from their offices in the United Kingdom to offices elsewhere.

Hedge fund activity in the Caribbean and the United States

A rise in loans to non-banks in offshore centres ...

Claims on non-banks surged, reflecting greater credit to these borrowers in the United States, the United Kingdom and offshore centres. In particular, the $185 billion rise in loans to non-banks in the United States in the most recent quarter was the largest quarterly increase for these borrowers since the BIS statistics have been collected. Most of these loans were extended by banks in the United Kingdom and Caribbean offshore centres, possibly reflecting the channelling of funds to non-bank financial institutions (eg securities firms and

Cross-border claims by sector and currency



[1] Exchange rate adjusted quarterly 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

hedge funds). Claims on non-banks *located in* the United Kingdom and Caribbean offshore centres – areas with considerable non-bank financial activity – were up as well, accounting for nearly one third of the total rise in claims on non-banks in the first quarter.

... is consistent with longer-term trends ...

Over the longer term, the stock of outstanding loans to non-bank borrowers in these three areas has grown substantially, dominating the quarterly movements in total claims in recent years. For example, BIS reporting banks' loan claims on non-banks in offshore centres and the United Kingdom have risen by 169% since end-1999, to $1 trillion in the most recent quarter.[1] Likewise, cross-border loans to non-banks in the United States have increased every quarter save three since end-1999, for a total increase of over $560 billion (or 110%). This stands in sharp contrast to the relatively small overall rise in domestic corporate lending in the United States over this same period.[2]

Overall, cross-border claims on non-banks in the Cayman Islands and the United States reflect many types of economic activity, making it virtually impossible to identify with certainty the drivers of quarterly flows. For example, the Cayman Islands hosts a variety of businesses, including fund management, hedge funds, structured finance and insurance,[3] all of which are classified as

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[1] The outstanding stock of loans to non-banks in the United Kingdom and offshore centres accounted for 27% of total loans to non-banks worldwide in the first quarter of 2005, up from 18% in 1999.

[2] The outstanding stock of commercial and industrial (C&I) loans booked by banks resident in the United States stood at $964 billion in the first quarter of 2005, up $36 billion from its end-1999 level. These C&I loans fell between early 2001 and mid-2004, but have been on the rise since. In the first quarter of 2005, C&I loans rose by $32 billion. These data can understate total C&I lending in the United States because they exclude loans booked offshore. See R McCauley and R Seth, "Foreign bank credit to U.S. corporations: the implications of offshore loans", *FRBNY Quarterly Review*, Spring, 1992.

[3] See E Dixon, "Financial flows via offshore financial centres", Bank of England, *Financial Stability Review*, June 2001.

non-banks in the BIS statistics. In a similar vein, cross-border loans to non-bank borrowers in the United States include corporate and household lending, as well as loans to securities firms and hedge funds.

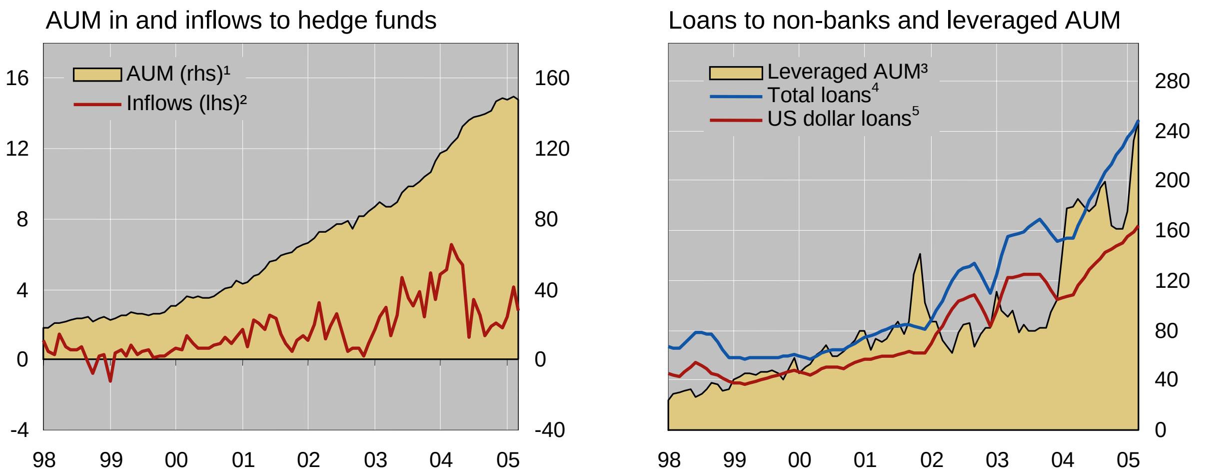
However, in both areas, hedge fund activity has expanded greatly since end-1999. Data from Hedge Fund Research (HFR), which track the monthly returns and assets under management (AUM) for a large sample of hedge funds,[4] indicate that total AUM in hedge funds legally domiciled in the Cayman Islands have increased almost fourfold since end-1999. Similarly, AUM in hedge funds in the United States have almost doubled over this period (Graphs 2.2 and 2.3, left-hand panels).

... and may partially reflect increased leverage in hedge funds

Over shorter horizons, there is also some indirect evidence that hedge funds' use of leverage, on top of the growth in AUM, may have contributed to the rise in loans to non-banks in these areas. As shown in the right-hand panel of Graph 2.2, the growth in loans to non-banks in the Cayman Islands accelerated, in stages, after 2003. Concurrently, estimates of the degree of leverage employed by hedge funds there – proxied by an indicator of the

Hedge fund activity in the Cayman Islands

In billions of US dollars



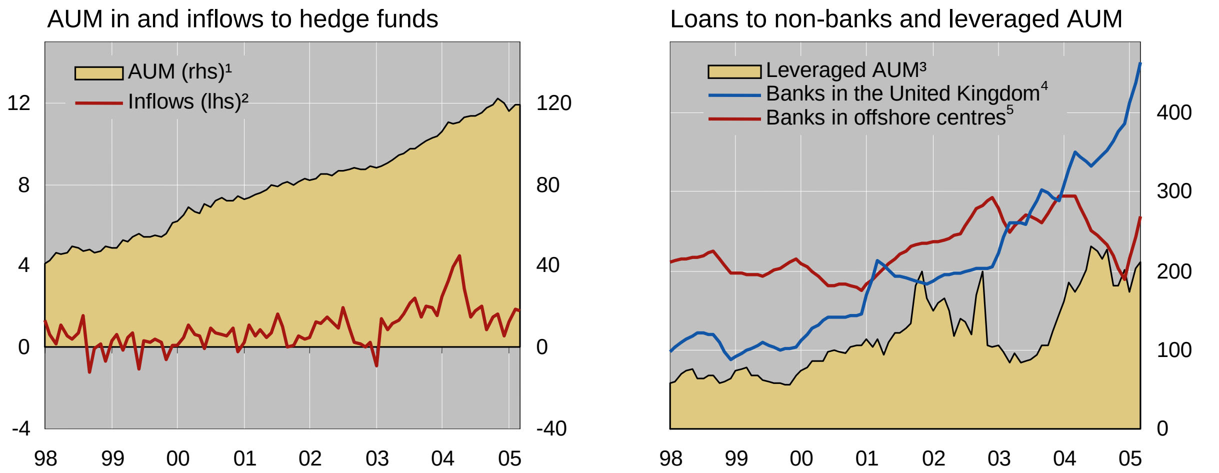
[1] Total assets under management (AUM) of 1,175 hedge funds legally domiciled in the Cayman Islands, as listed in the Hedge Fund Research (HFR) database. [2] Estimated net inflows into hedge funds legally domiciled in the Cayman Islands. Funds that disappear from the HFR database are assumed to have stopped reporting, and thus are not included in the calculation of net inflows in the month in which they disappear. [3] The estimate of leveraged AUM is based on the procedure detailed in P McGuire, E Remolona and K Tsatsaronis, "Time-varying exposures and leverage in hedge funds", *BIS Quarterly Review*, March 2005. Leverage is estimated separately for different families of hedge funds by regressing hedge fund returns on a variety of market-based risk factors using a 24-month rolling regression window. This measure is a rough indicator of *both* on-balance sheet leverage (through debt) *and* instrument leverage (such as through derivatives), and cannot differentiate between the two. Leveraged AUM for a particular family is the product of total AUM (average over the 24-month window) and the estimate of leverage. Total leveraged AUM is the sum across families. [4] Cross-border loans of BIS reporting banks (excluding banks in Japan) in all currencies to non-banks in the Cayman Islands. [5] Cross-border US dollar-denominated loans of BIS reporting banks (excluding banks in Japan) to non-banks in the Cayman Islands.

Sources: HFR; BIS calculations. Graph 2.2

[4] The HFR dataset does not include all hedge funds, and thus will underestimate total AUM and inflows.

Hedge fund activity in the United States

In billions of US dollars



[1] Total assets under management (AUM) of 1,515 hedge funds legally domiciled in the United States, as listed in the Hedge Fund Research (HFR) database. [2] Estimated net inflows into hedge funds legally domiciled in the United States. Funds that disappear from the HFR database are assumed to have stopped reporting, and thus are not included in the calculation of net inflows in the month in which they disappear. [3] The estimate of leveraged AUM is based on the procedure detailed in P McGuire, E Remolona and K Tsatsaronis, "Time-varying exposures and leverage in hedge funds", *BIS Quarterly Review*, March 2005. Leverage is estimated separately for different families of hedge funds by regressing hedge fund returns on a variety of market-based risk factors using a 24-month rolling regression window. This measure is a rough indicator of *both* on-balance sheet leverage (through debt) *and* instrument leverage (such as through derivatives), and cannot differentiate between the two. Leveraged AUM for a particular family is the product of total AUM (average over the 24-month window) and the estimate of leverage. Total leveraged AUM is the sum across families. [4] Cross-border loans to non-banks in the United States from banks located in the United Kingdom. [5] Cross-border loans to non-banks in the United States from banks located in offshore centres.

Sources: HFR; BIS calculations. Graph 2.3

sensitivity of their returns to a variety of risk factors[5] – edged upwards starting in late 2003. This has yielded a rise in the *estimated* total amount of *leveraged AUM* in the Cayman Islands, broadly consistent with the uptick in BIS reporting banks' loan claims. A similar, albeit less clear, trend is evident in the United States. The fluctuation in leveraged AUM in hedge funds legally domiciled there since 2003 is roughly in line with the pickup in loans from banks in the United Kingdom, and the subsequent drop-off in loans channelled by banks in offshore centres (Graph 2.3, right-hand panel).

Inflow to Asia-Pacific overshadows outflows from other regions

In the first quarter of 2005, emerging markets experienced a relatively large net inflow, the result of a sizeable increase in BIS reporting banks' cross-border claims on banks in Asia-Pacific. In contrast, substantial placements of deposits

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[5] The style analysis regression which generates the estimate of leverage is detailed in P McGuire, E Remolona and K Tsatsaronis, "Time-varying exposures and leverage in hedge funds", *BIS Quarterly Review*, March 2005. This measure is a rough indicator of *both* on-balance sheet leverage (through debt) *and* instrument leverage (such as through derivatives), and cannot differentiate between the two. Since that publication, the statistical procedure has been refined; it now incorporates additional risk factors and relies on a fixed effects empirical specification.

Cross-border bank flows to emerging economies

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

	Banks' positions[1]	2003 Year	2004 Year	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	Stocks at end-Mar 2005
Total[2]	Claims	64.9	131.6	67.9	26.0	1.6	36.2	76.1	1,256.9
	Liabilities	72.3	201.1	107.2	20.8	49.7	23.3	63.2	1,510.5
Argentina	Claims	–8.5	–5.3	–2.6	–1.1	–0.8	–0.7	–0.8	17.9
	Liabilities	–0.8	–0.3	0.3	0.1	–0.3	–0.5	–0.3	24.3
Brazil	Claims	–7.2	–7.4	1.8	–4.0	–2.1	–3.1	4.5	81.6
	Liabilities	14.4	–4.8	5.0	–3.6	–7.0	0.9	13.6	66.1
China	Claims	13.5	24.0	13.9	9.9	–3.1	3.2	10.0	101.5
	Liabilities	–6.4	25.8	21.6	20.3	–2.6	–13.5	–3.4	114.6
Czech Rep	Claims	3.7	2.7	–1.7	0.8	0.4	3.1	0.7	24.0
	Liabilities	–2.4	0.8	–2.6	2.5	–0.6	1.5	–0.8	10.3
Indonesia	Claims	–4.6	0.4	0.3	–0.9	0.2	0.7	–0.7	30.2
	Liabilities	0.2	–2.3	–0.2	–1.3	–0.1	–0.6	0.1	10.5
Korea	Claims	–1.0	12.6	14.3	–8.6	0.8	6.1	8.8	98.9
	Liabilities	7.3	13.8	21.7	–4.9	2.9	–5.9	–4.6	49.5
Mexico	Claims	–0.7	–0.8	7.5	–0.6	–6.7	–1.0	4.4	69.9
	Liabilities	6.2	–4.7	4.0	–0.7	–6.4	–1.6	2.0	59.7
Poland	Claims	3.3	5.9	2.4	2.0	1.5	–0.1	5.5	46.6
	Liabilities	–0.1	11.3	3.0	3.9	–0.2	4.6	1.6	32.3
Russia	Claims	12.1	8.9	3.4	–0.3	–1.8	7.6	3.3	65.4
	Liabilities	16.2	23.9	5.0	7.8	5.5	5.6	28.1	110.7
South Africa	Claims	–1.2	0.4	–0.1	0.5	–0.3	0.3	–0.2	19.3
	Liabilities	9.5	6.8	4.1	1.9	0.7	0.1	0.5	40.0
Thailand	Claims	–1.6	0.2	–1.0	–0.4	1.7	–0.1	0.5	20.0
	Liabilities	5.7	2.4	–1.5	1.2	1.7	1.0	2.6	23.1
Turkey	Claims	5.3	9.1	4.2	3.4	0.0	1.5	2.9	57.5
	Liabilities	–0.4	6.9	2.9	0.9	1.1	2.0	–1.5	26.2
Memo:									
New EU countries[3]	*Claims*	*20.9*	*30.3*	*3.9*	*6.6*	*8.4*	*11.5*	*15.1*	*175.5*
	Liabilities	*–0.4*	*17.4*	*3.2*	*4.8*	*0.0*	*9.4*	*0.7*	*84.3*
OPEC members	*Claims*	*–6.5*	*21.4*	*9.2*	*1.7*	*4.9*	*5.6*	*5.3*	*161.7*
	Liabilities	*–14.9*	*34.5*	*16.4*	*–1.7*	*24.1*	*–4.2*	*8.6*	*298.2*

[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

abroad by banks in Latin America and emerging Europe led to net outflows from these regions. The longer-term relationship between net claims on and the current account balances of emerging economies sheds light on the extent to which changes in external positions are channelled through BIS reporting banks.

Reporting banks channel US dollars to banks in Asia-Pacific

The borrowing of US dollars by banks in Asia-Pacific, a trend evident since mid-2002, continued in the most recent quarter. Total claims on the region rose by $34 billion to $442 billion in the first quarter of 2005. In particular, claims on banks in China increased by $9 billion to reach $77 billion, from a post-Asian crisis low of $31 billion in the second quarter of 2002. Similarly, new credit to banks over this period drove a rise in total claims on Korea and Taiwan (China)[6]. This rapid growth in claims on banks has been in US dollars, while claims on non-banks,[7] as well as non-US dollar claims on banks, have remained comparatively stable since 2002. Deposit liabilities vis-à-vis Asia-Pacific changed little in the most recent quarter. The banking sector in the region, including central banks, repatriated $8 billion in funds, even though the stock of foreign exchange reserves placed in banks abroad remained stable for many countries (eg India, Korea, Malaysia and Thailand). Banks in Korea and Taiwan together reduced their cross-border deposits – primarily US dollar-denominated – by $9 billion, while banks in Malaysia and Thailand increased the funds they placed in banks abroad.

Banks in Russia continue to place funds abroad

In contrast to Asia-Pacific, net funds flowed out of other emerging market regions. In Latin America, banks in Brazil and Venezuela increased the funds placed with BIS reporting banks, more than offsetting a rise in claims on banks in Brazil and non-banks in Mexico. This resulted in an $8 billion net outflow from the region. In emerging Europe, a substantial placement of deposits with BIS reporting banks by banks in Russia ($28 billion) overshadowed new lending to borrowers elsewhere in the region, and led to a $6 billion net outflow.[8] Russia's growing current account surplus sets it apart from other emerging European countries, which have been recording deficits. The Russian banking sector has accumulated significant deposits abroad since the sovereign default in 1998; deposit liabilities of BIS reporting banks have risen by a factor of 15 since the third quarter of 1998 to reach $101.6 billion in the last quarter. Only a portion of this rise reflects placements by the Russian central bank.[9]

Net claims on emerging markets reflect borrowers' external positions

The stock of BIS reporting banks' net claims can be affected by changes in the external positions of borrowing countries. In general, movements in net claims on a particular country reflect the recycling of current account balances

6 Hereinafter Taiwan.

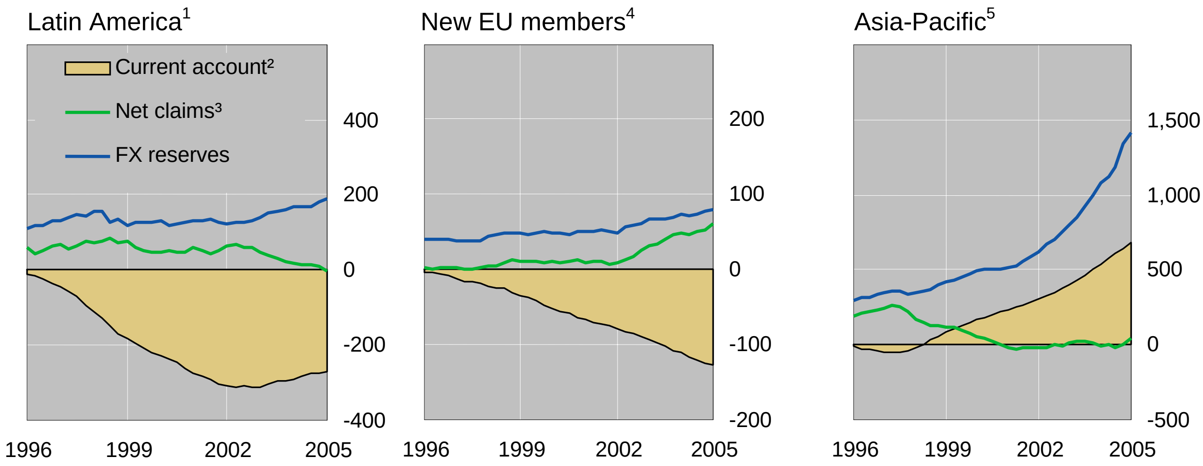
7 US dollar claims account for 88% of the increase in claims on Asia-Pacific banks since the third quarter of 2001. The share increases to 96% if claims on banks in Hong Kong SAR and Singapore, countries classified as offshore centres in the BIS statistics, are also considered.

8 New credit to borrowers in new EU member states contributed to a relatively large $23 billion rise in claims on emerging Europe.

9 Deposits by the Russian central bank currently account for 53% of the stock of BIS reporting banks' deposit liabilities vis-à-vis banks in Russia. Placements abroad by the Russian central bank accounted for roughly one third ($9.3 billion) of the increase in these liabilities in the first quarter of 2005. At the same time, securities holdings by the Russian central bank decreased by $4.4 billion. See also Graph 2 in R McCauley, "Distinguishing global dollar reserves from official holdings in the United States", in this *Quarterly Review*.

Net claims and external positions vis-à-vis emerging markets

In billions of US dollars



[1] Argentina, Brazil, Chile, Colombia, Mexico and Venezuela. [2] Cumulative current account balance as of 1995 Q4. [3] Total stock of net claims of BIS reporting banks. [4] The Czech Republic, Hungary and Poland. [5] China (reports on an annual basis; the conversion to quarterly frequency assumes that flows are evenly distributed throughout each year), India, Indonesia, Korea, Malaysia (from 1997 Q1 onwards), the Philippines, Taiwan (China) and Thailand.

Sources: IMF; BIS. Graph 2.4

and changes in the stock of official reserves held as deposits in banks abroad. This link has been particularly evident in Latin America and emerging Europe in recent years. The sustained fall in net claims on Latin America started in the aftermath of the Argentine default, coinciding with a switch to current account surpluses (Graph 2.4, left-hand panel).[10] This contrasts with the period between end-1998 and 2001, during which foreign banks' reduced exposure to the region was associated with the financing of sustained current account deficits by other financial intermediaries. In emerging Europe, the stock of net claims on new EU member states continued to rise in the first quarter of 2005, a trend evident since the third quarter of 2002 when clear signals emerged that these countries were set to join the Union (Graph 2.4, centre panel).[11] Since then, reporting banks' exposures have tracked the current account deficits in the region, which had previously been financed primarily by FDI inflows.

In contrast to Latin America and emerging Europe, the co-movement between net claims and external balances in Asia-Pacific, evident between 1996 and 2001, has been weaker in recent years. The rise in US dollar-denominated claims on the region's banking sector (discussed above) halted and even reversed the fall in the stock of net claims vis-à-vis the region (Graph 2.4, right-hand panel). Such inflows, which occurred against the backdrop of sustained current account surpluses and official intervention in the

[10] The FX reserves of Latin American countries started to rise in 2002 mainly as a result of investment in securities.

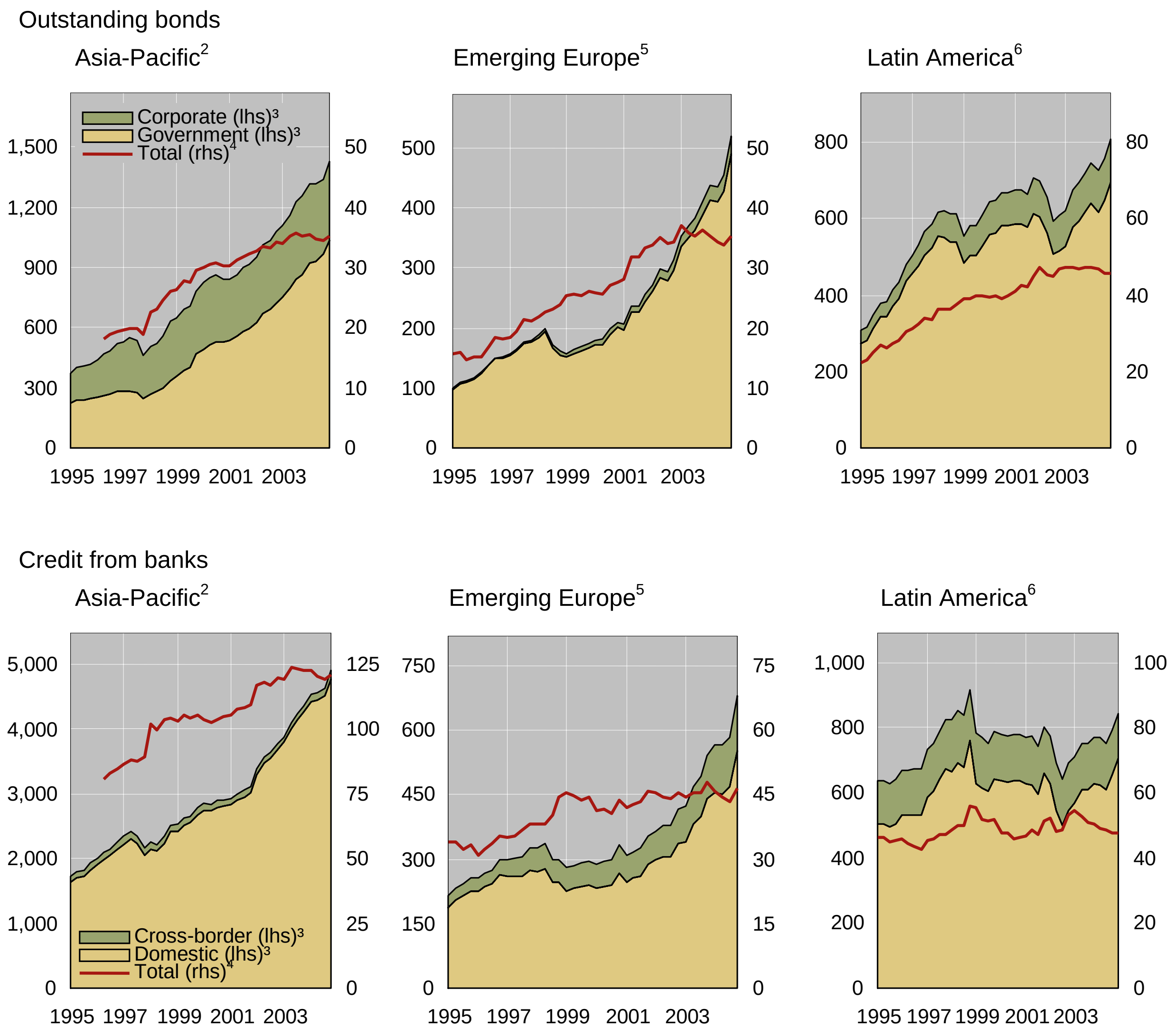
[11] The Irish referendum, which de facto indicated that the accession process was irreversible, took place in November 2002. Since then, the flow of claims into central Europe has been facilitated by the increasing western European ownership of banks in EU accession countries.

FX market, contributed to a pickup in the growth of FX reserves in Asia-Pacific countries.

Foreign bank participation in key emerging markets

Deregulation, the opening of capital accounts since the late 1980s, and the development of domestic bond markets have led to significant shifts in corporate and government financing patterns in many emerging markets. These shifts have, in some countries, reduced the overall importance of *loan financing* relative to *bond financing*. However, in all emerging market regions, banks remain the key source of *debt* financing for non-banks. While the growth in domestic and international bond issuance has allowed non-bank borrowers to tap a wider range of investors, banks continue to provide the bulk of credit, by extending loans or by purchasing bonds directly (Graph 2.5).

Credit to non-bank borrowers, by region[1]



[1] Data up to the fourth quarter of 2004. [2] China, India, Indonesia, Korea, Malaysia, the Philippines, Thailand and Taiwan (China). [3] In billions of US dollars. [4] As percentage of GDP. [5] The Czech Republic, Hungary, Poland, Russia and Turkey. [6] Brazil, Chile, Mexico and Venezuela.

Sources: IMF; BIS calculations. Graph 2.5

Foreign banks' share in domestic lending markets ...

Below we construct two measures of the degree to which foreign (ie foreign-headquartered) banks have made inroads into domestic (bank) credit markets. These measures can shed light on longer-term trends, in particular the integration of domestic banking systems and the growth in local lending by foreign banks. These issues are also discussed in the context of the syndicated loan data in the box on page 30.

Overall, these measures indicate that the foreign bank share of all bank credit to *non-banks* increased dramatically after 1995 in emerging European and Latin American economies, but has not risen further in either region in recent years. In Asia-Pacific, where domestic financial systems are significantly larger and more developed (Graph 2.5), foreign banks account for a relatively small share of total bank credit to non-banks, although there are significant differences across countries.

Measures of foreign bank participation[12]

The two measures serve as indicators of the extent and form of foreign bank financing of non-bank residents in a particular country. The first measure captures the importance of direct cross-border, or offshore, banking for a national lending market. This form of financing, conducted by or at least booked at foreign banks' offices located outside the borrower's country, is typically missed by domestic banking statistics. Specifically, the measure is calculated as the ratio of cross-border (*XB*) to total bank credit to non-banks, or *XB*/(*XB*+*DC*). The denominator of this ratio is the sum of cross-border (*XB*) and domestic bank credit (*DC*) to non-banks, and includes both loan and security claims.[13] As shown in the June 2005 *Quarterly Review*, cross-border banking has become more important in developed countries over the last two decades.

The second measure arguably captures foreign bank participation more fully, by incorporating foreign banks' local lending, ie the lending done by offices located in the borrowing country. The measure is calculated as the ratio of BIS reporting banks' cross-border *and* locally extended claims on non-banks to total bank credit to non-banks, or $(INT + LL)/(XB + DC)$.[14] In the numerator, international claims (*INT*) include cross-border and local claims in foreign

[12] These measures, discussed in detail in the June 2005 *BIS Quarterly Review*, capture the participation of BIS reporting banks only. This can lead to an underestimation of the degree of total foreign bank participation in a particular country if, for example, banks from non-reporting countries have a significant presence. In addition, these measures tend to underestimate overall *foreign* participation if, for example, domestic banks are owned by foreign non-bank entities (eg private equity firms).

[13] This measure may underestimate the role of foreign institutions because it ignores local lending by foreign bank offices located in the country. At the same time, it may overestimate the role of foreign institutions if domestic banks' offices located abroad account for a significant share of the cross-border credit received by domestic non-bank borrowers (this would be an instance of the so-called "round-tripping" of credit).

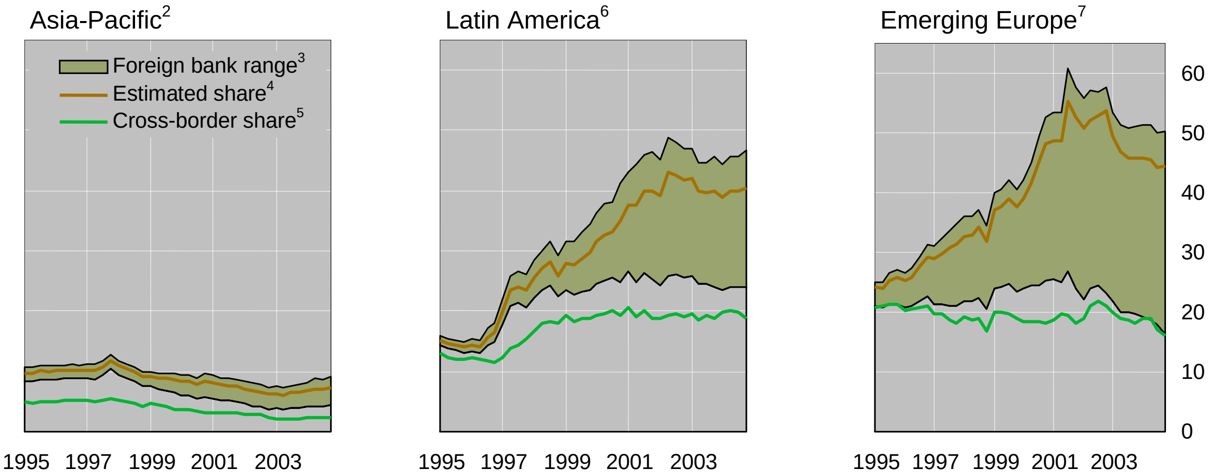
[14] The individual components used in constructing the two measures are converted to US dollars at current exchange rates rather than constant dollar exchange rates. From the borrowers' perspective, these measures represent the value of liabilities to foreign banks as a share in the value of total liabilities to all banks.

currencies on non-banks. Local claims in local currencies, *LL*, are not broken down by sector, and thus also include lending to other banks. Hence, the measure is presented as a range – with *LL* included and excluded from the numerator – in the graphs below.[15] A best-guess point estimate within this range is calculated by applying to *LL* the sectoral breakdown available for international claims (*INT*). While this may provide a more reasonable estimate for some countries, it can be misleading for countries where the sectoral distributions of international and local currency claims differ.

Applying these measures to the data

The evidence based on these measures suggests that foreign banks supply a significant share of total bank credit in Latin America and emerging Europe, while their share is considerably smaller in Asia-Pacific (Graph 2.6). Cross-border banking, captured by the first measure, has remained mostly flat in all three regions, at near 20% of total bank credit in Latin America and Europe, but below 10% in Asia-Pacific. The total participation of foreign banks, however, seems to have risen significantly in some regions, primarily due to the growth in locally extended claims. Foreign bank participation increased steadily in emerging Europe and Latin America until 2002, only to stall in the former region and reverse its course in the latter thereafter. In contrast, foreign banks account for a relatively low share of total bank credit to non-banks in Asia-Pacific.

Foreign bank participation in emerging markets, by region[1]



[1] Data up to the fourth quarter of 2004. [2] China, India, Indonesia, Korea, Malaysia, the Philippines, Thailand and Taiwan (China). [3] The lower bound is the ratio of international claims on non-banks (which include local claims in foreign currency) to total credit to non-banks (domestic credit plus cross-border claims). The inclusion of local claims in local currency (on all sectors) in the numerator yields the upper bound. [4] Implied foreign bank share from applying the sectoral breakdown available for international claims to local currency claims. [5] Ratio of BIS reporting banks' cross-border claims on non-banks to total credit to non-banks. [6] Brazil, Chile, Mexico and Venezuela. [7] The Czech Republic, Hungary, Poland, Russia and Turkey.

Sources: IMF; BIS calculations. Graph 2.6

[15] The upper bound is equivalent to assuming that all local claims in local currency are vis-à-vis non-banks, while the lower bound, which excludes *LL* from the numerator, is equivalent to assuming that these claims are vis-à-vis banks.

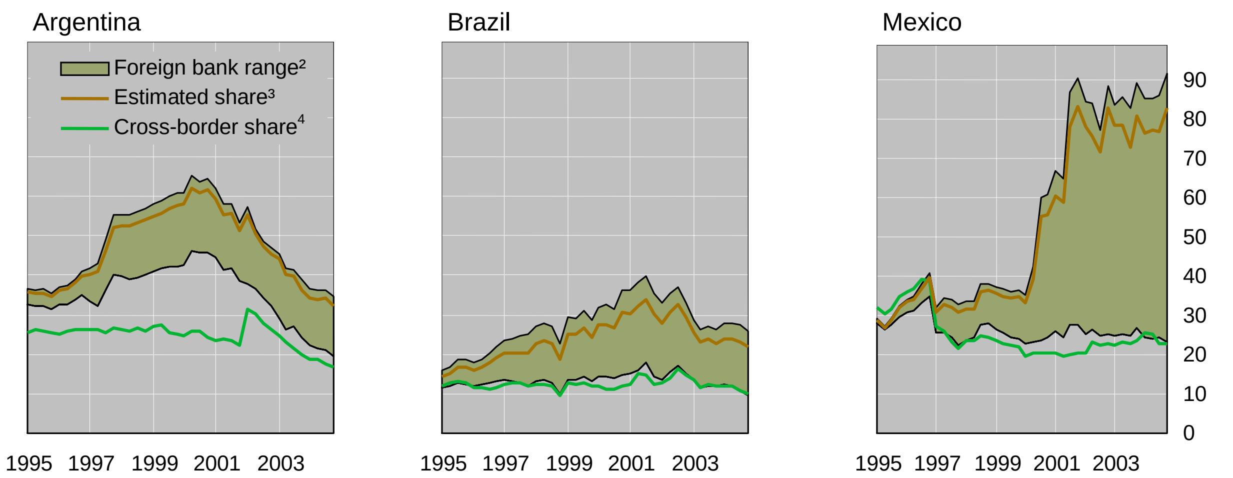
In Latin America, the rise in the estimated rate of foreign bank participation is mostly the result of larger local positions, primarily in Mexico (Graph 2.7). The stock of locally extended credit in Mexico expanded after 2000 following the acquisition of several domestic banks by foreign (Spanish and US) banks.[16] As a result, the upper bound on the estimated range of foreign banks' share of total bank credit in Mexico has risen above 80%, from less than 35% at end-1999. Elsewhere, foreign banks accounted for an estimated 60% of total bank credit to non-bank borrowers in Argentina in the fourth quarter of 2000, up from less than 40% in 1995. However, following the government bond default, a reduction in cross-border lending by BIS reporting banks drove down the estimated foreign bank share to less than 40% in the fourth quarter of 2004.

... has risen in Latin America ...

As in Latin America, foreign banks account for a relatively high share of total bank credit in emerging Europe. The lower bound on the measure of foreign bank participation has remained roughly constant since 1996, while the upper bound has risen significantly, reflecting greater local currency lending in the region (Graph 2.6). Graph 2.8 provides some evidence that foreign bank participation has been on the rise in the new EU member countries, as both the upper and lower bounds have trended upwards. For individual countries, foreign banks accounted for 40–60% of total bank credit in Hungary, and 35–80% in Poland, in the fourth quarter of 2004. While these estimated ranges are quite wide, their lower bound has indeed risen in each case since 1995. In contrast, foreign bank participation rates remain low, and local currency positions small, in Russia and Turkey.

... and in emerging Europe ...

Foreign bank participation in selected Latin American countries[1]

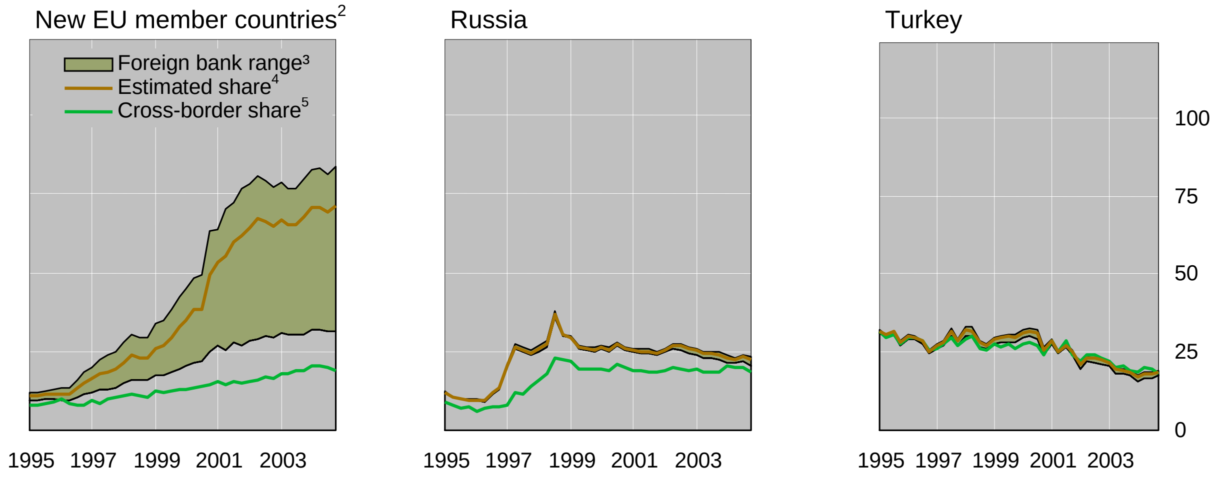


[1] Data up to the fourth quarter of 2004. [2] The lower bound is the ratio of international claims on non-banks (which include local claims in foreign currency) to total credit to non-banks (domestic credit plus cross-border claims). The inclusion of local claims in local currency (on all sectors) in the numerator yields the upper bound. [3] Implied foreign bank share from applying the sectoral breakdown available for international claims to local currency claims. [4] Ratio of BIS reporting banks' cross-border claims on non-banks to total credit to non-banks.

Sources: IMF; BIS calculations. Graph 2.7

[16] Claims of banks in the United States account for a significant share of claims vis-à-vis Mexico.

Foreign bank participation in selected emerging European countries[1]



[1] Data up to the fourth quarter of 2004. [2] The Czech Republic, Hungary and Poland. [3] The lower bound is the ratio of international claims on non-banks (which include local claims in foreign currency) to total credit to non-banks (domestic credit plus cross-border claims). The inclusion of local claims in local currency (on all sectors) in the numerator yields the upper bound. [4] Implied foreign bank share from applying the sectoral breakdown available for international claims to local currency claims. [5] Ratio of BIS reporting banks' cross-border claims on non-banks to total credit to non-banks.

Sources: IMF; BIS calculations. Graph 2.8

... but not in Asia-Pacific

In general, BIS reporting banks account for a smaller share of total bank credit to non-banks in Asia-Pacific, although differences across countries are substantial (Graph 2.9).[17] While this overall share has risen slightly in recent quarters, Asia-Pacific differs from Latin America and emerging Europe in at least two respects. First, the overall level of foreign bank participation remains below that in other regions. Second, BIS reporting banks' local currency positions have not expanded as they have elsewhere. While this is partially due to China and India, which have relatively closed banking systems and large domestic bank credit markets, Korea and Taiwan also have relatively low levels of foreign bank participation.[18] In contrast, other countries, namely Malaysia and the Philippines, have foreign bank participation rates approaching those in other emerging market regions.

The funding of local currency positions

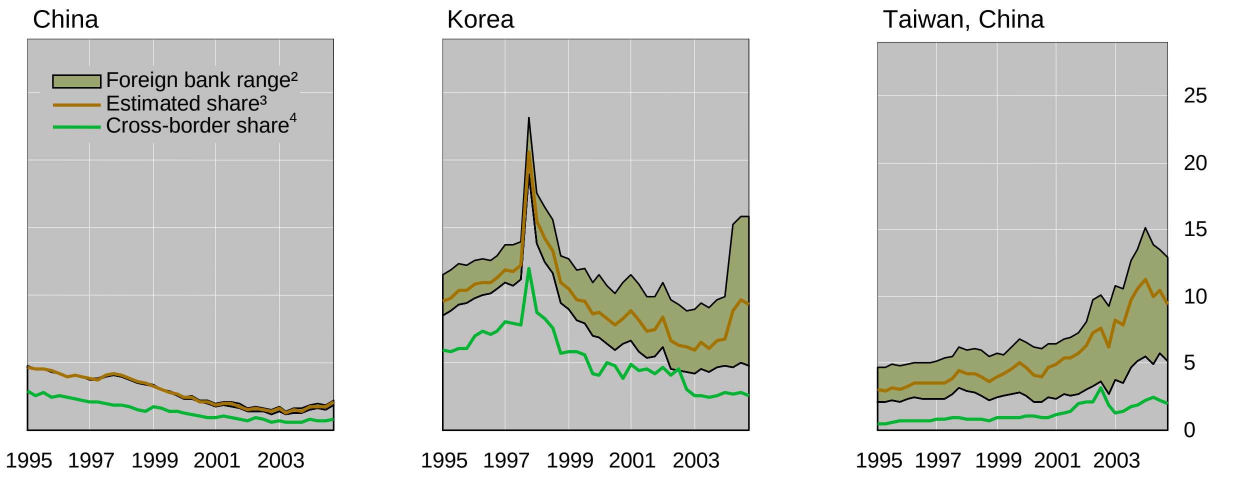
The dramatic rise in BIS reporting banks' local lending in local currencies, implied by the widening range of foreign bank participation shown in the previous graphs, has gone hand in hand with a roughly equal rise in local currency liabilities. This has helped to largely insulate foreign banks from

The United States reports local and cross-border claims, rather than international and local claims in local currencies. This depresses the lower bound of the estimated range for the share of foreign banks in national lending markets, while raising the upper bound.

[17] In absolute terms, BIS reporting banks' claims on Asia-Pacific are relatively large. The outstanding stock of foreign claims (ultimate risk basis) vis-à-vis all sectors in Asia-Pacific stood at $600 billion in the first quarter of 2005, compared with $495 billion vis-à-vis emerging Europe and $515 billion vis-à-vis Latin America. International claims on non-banks in Asia-Pacific stood at $241 billion, compared with $252 billion vis-à-vis emerging Europe and $180 billion vis-à-vis Latin America.

[18] These measures do not capture the ownership of local banks by foreign investment funds.

Foreign bank participation in selected Asia-Pacific countries[1]



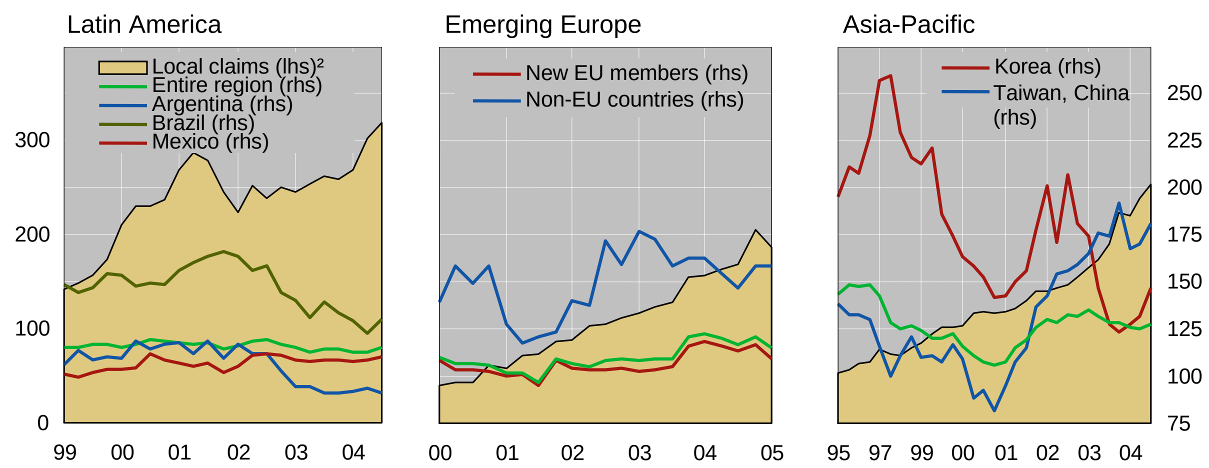
[1] Data up to the fourth quarter of 2004. [2] The lower bound is the ratio of international claims on non-banks (which include local claims in foreign currency) to total credit to non-banks (domestic credit plus cross-border claims). The inclusion of local claims in local currency (on all sectors) in the numerator yields the upper bound. [3] Implied foreign bank share from applying the sectoral breakdown available for international claims to local currency claims. [4] Ratio of BIS reporting banks' cross-border claims on non-banks to total credit to non-banks.

Sources: IMF; BIS calculations. Graph 2.9

exchange rate risk. Still, as shown in Graph 2.10, the ratio of reporting banks' local currency claims to local currency liabilities is typically higher than unity. This possibly reflects foreign banks' advantage in local lending (over local deposit taking), and their ability to fund these local claims by borrowing foreign currency offshore and swapping it into local currency. In addition, local claims may also reflect purchases of domestic bonds indexed to currency movements, which can be financed in foreign currency without incurring exchange rate risk.

The variability in the ratio of local currency claims to liabilities over time, as well as its overall level, differs across countries. In Latin America, this ratio has been stable and close to unity since 1999, but has recently trended

Local currency claims on emerging markets[1]



Note: Lines depict the ratio of BIS reporting banks' local currency claims to local currency liabilities, in percentage points.

[1] The United States reports local claims in all currencies. [2] Outstanding stock of local claims in local currency; in billions of US dollars. Graph 2.10

downwards, most noticeably in Argentina and Brazil after the Argentine default in 2002.[19] In contrast, this ratio has, on average, risen in emerging Europe as the integration of the new EU member states in euro area financial markets has progressed. In Asia-Pacific, this ratio has been volatile since the Asian crisis. Local currency claims on the region have increased since the second quarter of 2001, relative to local currency liabilities, mainly as a result of developments in Korea and Taiwan.

19 In Brazil, this may be linked to the slowdown in the issuance of sovereign indexed bonds, which would appear as local currency claims in the BIS statistics.

Developments on the syndicated loan market

Blaise Gadanecz

Strong activity in the second quarter of 2005

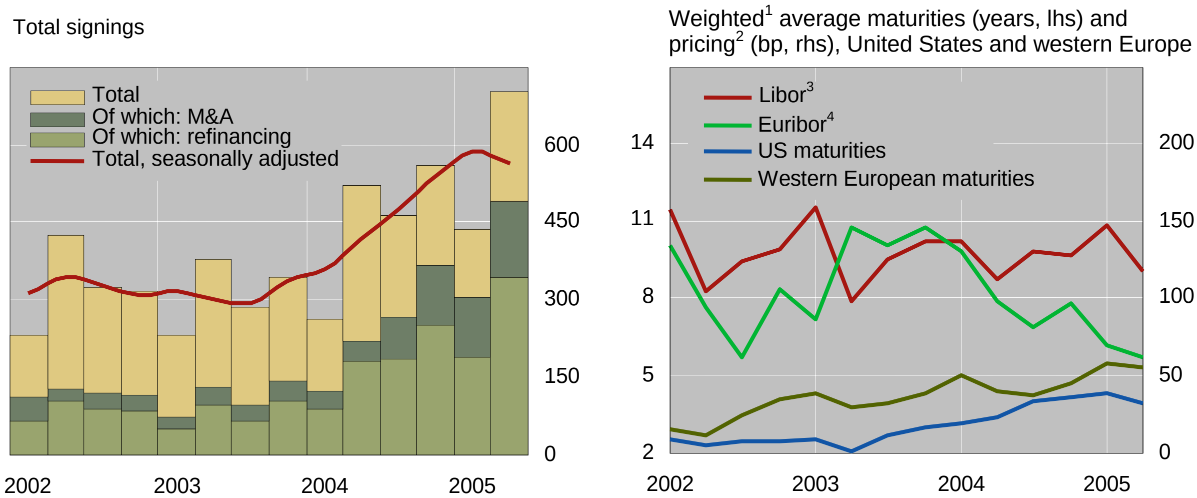
Activity on the international syndicated loan market was strong in the second quarter of 2005. Signings rose by about $270 billion from the previous quarter to $703 billion, up $180 billion from one year previously.[①] Given that activity in the second quarter of each year is traditionally robust, and that the market had been buoyant in recent quarters, on a seasonally adjusted basis total volumes dropped slightly from those registered in the first quarter.

As in previous quarters, the M&A segment and refinancings drove the market in industrialised countries. Merger-related activity continued to be strong in the United States. Western European borrowers took advantage of favourable market conditions to lock in low spreads and rolled over an unprecedented $200 billion, or almost twice the volume of refinancing in the first quarter. Indeed, financing terms continued to be favourable for borrowers from industrialised countries. This was reflected in persistently low average Libor and Euribor pricing, particularly in the investment grade segment, although average maturities dropped slightly. Even though bond issuance spreads stayed relatively high after the downgrades of General Motors and Ford, primary loan spreads reportedly remained below those observed for comparable risks on CDS or bond markets. The wish to foster bank-client relationships may have accounted for such pricing differences.

Lending to emerging market borrowers peaked at $45 billion, a level not seen since the end of 1997. All emerging regions except Asia-Pacific enjoyed lower spreads compared to the previous quarter. In several new EU member countries such as Hungary and Slovenia, large financial and non-financial borrowers have been able to secure deals at spreads close to levels paid by their western European counterparts. In Latin America, the oil and cement sectors secured exceptionally cheap loans.

Signings of international syndicated credit facilities

In billions of US dollars



[1] By facility sizes. [2] Spreads + fees. [3] US dollar-denominated facilities with Libor pricing granted to US borrowers. [4] Euro-denominated facilities with Euribor pricing granted to western European borrowers.

Sources: Dealogic Loanware; BIS.

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① Activity in the second quarter of 2005 was also stronger than in the fourth quarter of 2004, when signings had peaked at $559 billion.

Regional integration of the syndicated loan market in emerging market countries

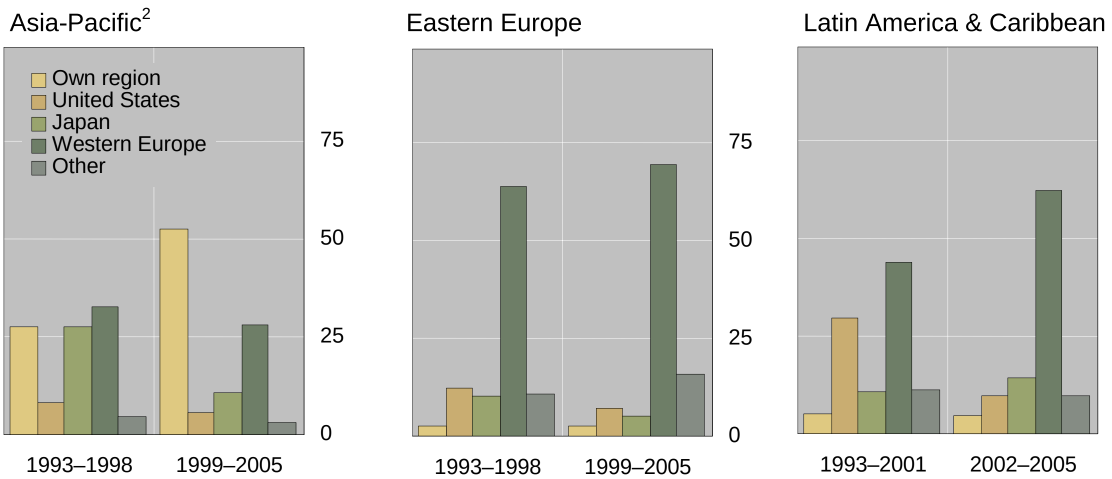
The analysis of syndicate structures makes it possible to assess the origin of lending flows to emerging market countries and, by extension, the geographical integration of these syndicated loan markets. This exercise shows that it is mainly Japanese, US and western European banks which have been providing syndicated loans to emerging market countries, and that, for the remaining part, this type of lending has been primarily a domestic phenomenon, not a regional one.

Over the past decade, borrowers from Asia and the Pacific have obtained the highest share of the total funds they have received from banks headquartered in their own region. This share has averaged 40% over the past decade (see graph below) and has risen since the Asian crisis, to the detriment of Japanese banks. Conversely, in eastern Europe and Latin America, banks from outside these regions have had a much more significant presence, and the share of home region banks in total commitments has not exceeded 10%. In Latin America, western European – among them, Spanish – banks have had a strong and growing presence: together with US lenders, they have provided more than 70% of funds over the past 10 years.

A closer examination of individual lender nationalities can be used to further investigate the composition of syndicated lending in Asia, the market where home region banks have been most prominent in the provision of syndicated loans. Such a country breakdown (not shown) indicates that most intraregional Asian lending has in fact been domestic, consistent with the low measures of cross-border intra-Asian bank lending flows apparent in the BIS international banking statistics. The majority of this domestic business has taken place in China, Korea and Taiwan, with the borrowers (and banks) of other Asian countries participating significantly less on the syndicated loan market.

Geography of syndicated lending[1] to emerging market countries

Fund provider group nationalities, in % of loan amounts provided, average for 1993–2005



[1] Includes domestic facilities. [2] Includes Hong Kong SAR and Singapore.