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2. The international banking market

In the second quarter of 2005, interbank activity drove the strong growth in BIS reporting banks' cross-border claims. Banks channelled funds to other banks in the United States, the United Kingdom and offshore centres, with inter-office transactions accounting for roughly one third of the total. Credit to non-bank borrowers also continued to rise, as banks invested in debt securities, primarily issued in the euro area.

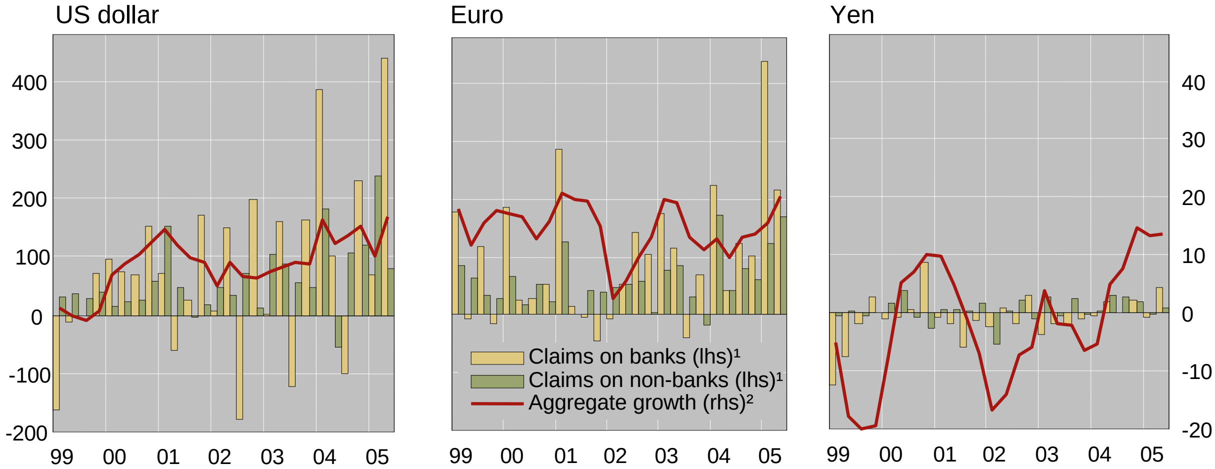
Emerging economies as a whole experienced a large net outflow of funds in the second quarter. The current rise in oil prices has led to large capital outflows from oil-exporting countries. As a result, deposits placed in BIS reporting banks have been on the rise as these countries have channelled a portion of these outflows into banks abroad. In the second quarter, increased placements by residents of Russia, Saudi Arabia, Venezuela and other oil-exporting countries were behind the relatively large net outflow of funds from emerging economies observed in the BIS data.

From a longer-term perspective, the recycling of petrodollars back into the international financial system in the most recent cycle differs in several important respects from the pattern observed during previous periods of rising oil prices. While oil-exporting countries historically placed a significant portion of their petrodollars in bank deposits, they have channelled a greater share of these funds elsewhere in the most recent cycle. This has contributed to a rise in the proportion of petrodollars that cannot be accounted for on the basis of counterparty data. Furthermore, while petrodollar deposits have once again become significant, the importance of OPEC as a source of funds for BIS reporting banks has nevertheless diminished over time.

Cross-border expansion in claims reflects interbank activity

Total cross-border claims continued to grow strongly for a second consecutive quarter, mainly owing to interbank activity (Graph 2.1). BIS reporting banks' total claims rose by $1.1 trillion in the second quarter of 2005 and reached $23.1 trillion. This pushed the year-on-year growth in claims to 16%, the highest rate recorded in the BIS statistics since the first quarter of 1988. This interbank lending was primarily channelled to banks in the United States, the United Kingdom and offshore centres, with inter-office transfers of funds accounting for roughly one third of the total.

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

Credit to non-bank borrowers also continued to grow in the second quarter as reporting banks invested in debt securities, primarily issued by borrowers in the euro area. Total claims on non-banks rose by $284 billion, the fourth consecutive quarter of strong growth in claims on this sector. Almost one quarter of this reflected increased claims on these borrowers in offshore centres, areas which host considerable non-bank financial activity. In addition, banks in Japan and the United Kingdom channelled a combined $136 billion into debt securities, primarily issued by non-bank borrowers in the euro area and the United States. Overall, claims on non-banks in the euro area rose by $147 billion, $87 billion of which constituted intra-euro area activity.

Oil exporters place deposits in BIS reporting banks

Emerging economies as a whole experienced a large net outflow of funds as oil-producing countries deposited funds in BIS reporting banks. At $43 billion, the net outflow of funds from emerging markets in the second quarter was the third largest recorded in the BIS statistics. Residents of OPEC member countries placed $26 billion in deposits with BIS reporting banks in the second quarter, following $8 billion in the previous quarter and $23 billion in the third quarter of 2004. Similarly, banks in Russia have continued to deposit funds abroad, a trend evident since end-2001. Their record $29 billion placement of (primarily euro-denominated) deposits in BIS reporting banks in the second quarter was only slightly larger than their placement in the previous quarter.

Petrodollars and the international banking system

The rise in oil prices since 1999 has led to a surge in petrodollars, ie US dollar payments to oil exporters. These funds must either be spent on imports or invested elsewhere in the world in the form of foreign direct investment (FDI), purchases of securities or placements in bank deposits. The way in which oil-producing countries have reacted since 1999 differs from the patterns of consumption and investment following the second oil shock in 1979. Piecing

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-Jun 2005
	Year	Year	Q2	Q3	Q4	Q1	Q2	
Total cross-border claims	1,076.7	2,284.8	240.1	227.2	588.7	1,033.4	1,083.9	20,263.2
on banks	530.6	1,367.7	191.3	–5.5	362.2	596.6	784.6	12,934.2
on non-banks	546.1	917.1	48.8	232.7	226.5	436.9	299.2	7,328.9
of which Loans: banks	453.4	1,074.8	130.1	37.0	300.2	394.1	710.3	10,971.1
non-banks	277.9	548.9	–25.8	178.5	124.4	292.1	92.1	3,755.5
of which Securities: banks	75.6	124.8	51.0	–153.5	36.5	110.0	44.7	1,376.8
non-banks	208.5	252.2	33.5	41.9	58.4	81.8	226.0	3,111.9
Total claims by currency								
US dollar	580.7	967.8	61.6	9.6	277.8	270.5	498.4	8,681.6
Euro	502.7	837.7	81.0	202.4	154.2	604.6	398.6	7,835.5
Yen	–127.2	251.5	50.7	36.8	185.4	–52.0	80.1	1,237.9
Other currencies[2]	120.5	227.9	46.8	–21.6	–28.8	210.3	106.8	2,508.2
By residency of non-bank borrower								
Advanced economies	452.3	672.5	29.4	128.9	149.7	373.4	212.2	5,647.7
Euro area	157.6	239.1	33.1	8.7	43.7	110.5	147.1	2,486.0
Japan	38.4	72.8	21.4	15.6	35.8	–31.5	10.6	235.3
United States	172.5	164.4	–25.1	38.9	45.5	207.2	28.9	1,889.0
Offshore centres	100.0	238.8	33.8	106.0	57.4	56.3	64.4	983.8
Emerging economies	6.1	49.9	2.3	1.2	22.0	13.2	23.6	649.2
Unallocated[3]	–13.5	–39.2	–14.3	–6.2	–2.8	–6.3	–2.2	19.5
Memo: Local claims[4]	*415.1*	*220.1*	*34.2*	*3.2*	*–5.9*	*233.5*	*–3.3*	*2,850.5*

[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

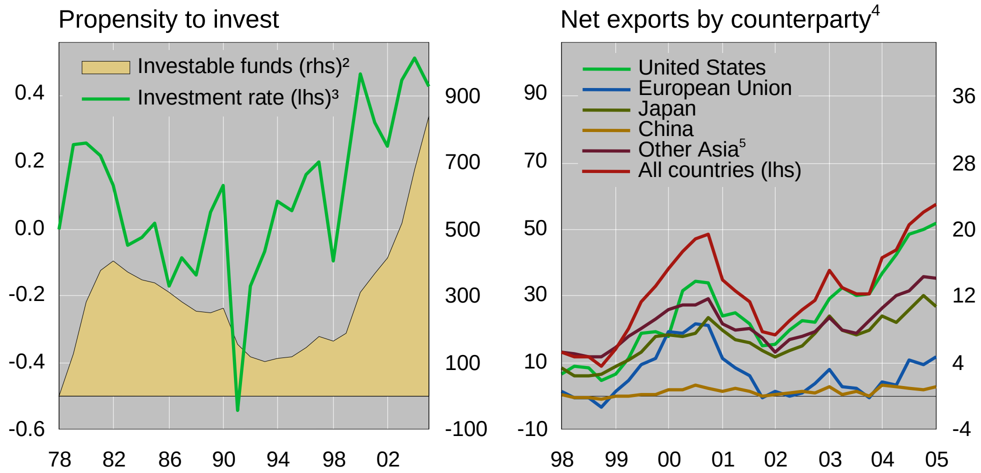
together various sources of data, this section compares these two episodes, and highlights how the role of banks has differed across the two. The data suggest that petrodollars are being invested more broadly across assets and countries in the most recent oil price cycle. As a result, the international banking system is less important as a repository of these funds than it once was.

Saving more of the surplus

Surging oil revenues …

The most recent oil price cycle started in 1999, and has generated substantial inflows into oil-exporting countries. Between the fourth quarter of 1998 and the third quarter of 2000, real oil prices rose by 207%. After falling by almost 50% in 2001, real oil prices have subsequently risen by about 170%, but remain below their peak of $105 per barrel reached at end-1979. As a result, revenue from oil exports is surging. OPEC members have earned an estimated $1.3 trillion in petrodollars since end-1998, while the world's other large

OPEC's net exports and investment abroad[1]



[1] Excluding Indonesia. [2] Defined as the sum of the current account balances of and financial inflows into OPEC countries, cumulated since end-1978. The 2005 value is estimated on the basis of OPEC net oil revenue data. The series is in billions of real 2005 Q2 US dollars, deflated by the US consumer price index. [3] Flow of investable funds as a share of the flow of net oil revenues. [4] In billions of US dollars. [5] Excluding China and Japan.

Sources: US Department of Energy, Energy Information Administration (EIA); IMF; BIS. Graph 2.2

exporters, Russia and Norway, have received $403 billion and $223 billion respectively.[1] Overall, net oil revenues in oil-exporting countries in 2005 are expected to reach $650 billion, although these estimates are thought to be on the low side because they are based on forecasts made in mid-2005.

… lead to greater investment abroad by OPEC

Relative to previous oil cycles, the propensity for OPEC countries to invest these oil revenues abroad seems to have risen. An indirect estimate of OPEC's total foreign investment – or "investable funds" – is the sum of OPEC countries' current account surpluses and their gross financial inflows.[2] As shown in Graph 2.2, the ratio of the flow of investable funds to the flow of net oil revenues has been higher in the 1999–2005 cycle than in the 1978–82 cycle, implying a higher rate of foreign placements.

The main sources of OPEC's investable funds have been the United States and Asia. Direction of trade data indicate that net exports from OPEC member countries to the United States cumulated over the 1999 Q1–2005 Q1 period totalled $277 billion. Similarly, net exports to Japan over this period

[1] Estimates of net oil revenue are drawn from annual data from the US Energy Information Administration. Indonesia and Ecuador are not included as OPEC members in the discussion which follows. In addition to Russia and Norway, the other non-OPEC oil-producing countries (and their cumulative 1999–2005 estimated net oil revenue) that are included in the list of oil-exporting countries used in this discussion are Angola ($65 billion), Egypt ($12 billion), Mexico ($105 billion) and Oman ($60 billion).

[2] Gross financial inflows are partially based on estimated data. Some items in the balance of payments data for several countries are not available for recent quarters, and are estimated by extrapolating from earlier periods. In addition, no data on gross financial inflows are available for the United Arab Emirates, Qatar and Iraq. Estimates for these countries are based on their current account and foreign exchange reserves data. These estimates imply that cumulative financial inflows accounted for 18% of cumulative investable funds over the 1999–2005 cycle, but were negligible in the previous cycle.

totalled $186 billion, and those to China and other Asian countries $245 billion. While gross oil exports to the countries in the European Union have also grown, imports from these countries have largely kept pace, leaving OPEC's net export position vis-à-vis the euro area, at $76 billion, small by comparison with other countries (Graph 2.2, right-hand panel).[3] The increased trade between OPEC countries and the euro area is evident in the rising share of trade financing arranged by euro area banks, as discussed in the box on page 29.

Tracking the outflow of petrodollars

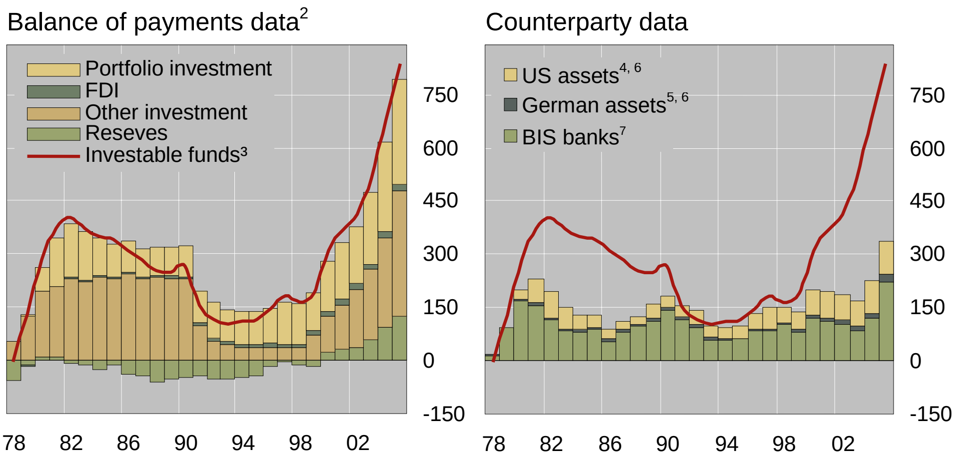
OPEC's foreign investment …

OPEC's investable funds show up as claims on the rest of the world, through purchases of foreign debt securities, FDI or foreign bank deposits. The left-hand panel of Graph 2.3 decomposes OPEC countries' investable funds into the change in foreign exchange reserves and the various components of the financial account, as dictated by the balance of payments identity.

These data indicate a marked change in the types of foreign investment across the two cycles. Since 1999, 28% of cumulative investable funds have been channelled into portfolio investment – or net purchases of foreign financial assets by non-monetary authorities – compared with 38% in the

Cross-border investment by OPEC countries[1]

Cumulative flows since 1977 Q4



Note: Data are in billions of real 2005 Q2 US dollars, deflated by the US consumer price index.

[1] Excluding Indonesia. [2] Outflows from OPEC member countries, as implied by the financial accounts in their balance of payments data. Balance of payments data for 2005 are estimated on the basis of EIA data on OPEC net oil revenues. [3] Defined as the sum of the current account balances of and financial inflows into OPEC countries. [4] Purchases of US long-term securities and FDI in the United States by "Other Asia" and Venezuela. [5] Purchases of German securities and FDI in Germany by OPEC countries. [6] The available data may underestimate OPEC's true net purchases of foreign securities to the extent that these purchases are conducted through financial intermediaries in third countries. [7] Total claims of OPEC countries on BIS reporting banks, primarily bank deposits.

Sources: Deutsche Bundesbank; IMF; US Treasury; BIS. Graph 2.3

[3] Total net exports of OPEC countries cumulated over 1999–2005 reached $852 billion. OPEC's aggregate current account surplus in 2004, at $140 billion (excluding Indonesia), was roughly the same as that for the major emerging economies in Asia-Pacific ($149 billion).

Cross-border bank flows to emerging economies

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

	Banks' positions[1]	2003	2004	2004			2005		Stocks at end-Jun 2005
		Year	Year	Q2	Q3	Q4	Q1	Q2	
Total[2]	Claims	64.9	131.2	26.0	1.6	35.8	70.6	21.8	1,267.8
	Liabilities	72.3	200.8	21.2	49.7	23.1	60.2	64.4	1,547.1
Argentina	Claims	–8.5	–5.3	–1.1	–0.8	–0.7	–1.3	–0.6	16.5
	Liabilities	–0.8	–0.3	0.1	–0.3	–0.5	–0.1	1.0	25.0
Brazil	Claims	–7.2	–7.4	–4.0	–2.1	–3.1	2.9	0.8	80.1
	Liabilities	14.4	–4.8	–3.6	–7.0	0.9	13.3	–9.3	55.7
China	Claims	13.5	24.0	9.9	–3.1	3.2	10.0	–2.7	97.3
	Liabilities	–6.4	25.8	20.3	–2.6	–13.6	–3.3	6.8	120.3
Czech Rep	Claims	3.7	2.7	0.8	0.4	3.1	0.7	–0.3	23.4
	Liabilities	–2.4	0.8	2.5	–0.6	1.5	–0.8	2.3	12.5
Indonesia	Claims	–4.6	0.3	–0.9	0.2	0.7	–0.6	1.9	31.0
	Liabilities	0.2	–2.3	–1.3	–0.1	–0.6	0.1	0.6	10.9
Korea	Claims	–1.0	12.6	–8.6	0.8	6.0	8.9	–2.5	95.4
	Liabilities	7.3	13.8	–4.9	2.9	–6.0	–4.6	–8.7	40.4
Mexico	Claims	–0.7	–0.8	–0.6	–6.7	–1.0	0.5	–1.8	63.7
	Liabilities	6.2	–4.7	–0.7	–6.4	–1.6	–1.5	2.3	58.1
Poland	Claims	3.3	5.9	2.0	1.5	–0.1	5.5	2.5	51.4
	Liabilities	–0.1	11.3	3.9	–0.2	4.6	1.6	1.4	33.2
Russia	Claims	12.1	8.9	–0.3	–1.8	7.6	3.3	1.7	66.8
	Liabilities	16.2	23.9	7.8	5.5	5.6	28.1	28.9	136.6
South Africa	Claims	–1.2	0.4	0.5	–0.3	0.3	–0.2	3.2	21.9
	Liabilities	9.5	6.8	1.9	0.7	0.1	0.6	1.6	41.0
Thailand	Claims	–1.6	0.2	–0.4	1.7	–0.1	0.5	4.3	24.0
	Liabilities	5.7	2.4	1.2	1.7	1.0	2.6	1.4	24.1
Turkey	Claims	5.3	9.1	3.4	0.0	1.5	3.0	2.0	58.8
	Liabilities	–0.4	6.9	0.9	1.1	2.0	–1.5	2.5	28.0
Memo:									
New EU countries[3]	*Claims*	*20.9*	*30.3*	*6.6*	*8.4*	*11.5*	*15.1*	*8.2*	*189.4*
	Liabilities	*–0.4*	*17.4*	*4.8*	*0.0*	*9.4*	*0.7*	*1.9*	*85.7*
OPEC members	*Claims*	*–6.5*	*21.3*	*1.7*	*4.9*	*5.5*	*5.4*	*5.0*	*163.0*
	Liabilities	*–14.9*	*34.5*	*–1.7*	*24.1*	*–4.2*	*8.1*	*26.7*	*319.2*

[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

1978–82 cycle. "Other investment", which primarily constitutes deposits in foreign banks but also investment not classified elsewhere, has fallen as a share of investable funds, from 58% in the previous cycle to 47% in the current one. Foreign exchange reserves have risen by $136 billion since end-1998, accounting for 19% of cumulative investable funds. In contrast, reserves accounted for a negligible fraction of cumulative investable funds in the earlier cycle.[4]

A more detailed tracking of where these investable funds are placed is difficult because OPEC member countries generally do not provide a finer breakdown of their capital outflows. The right-hand panel of Graph 2.3, however, splices various sources of *counterparty* data in order to get a better handle on what is known about aggregate outflows from OPEC countries. Cumulative net purchases of US and German securities are combined with OPEC FDI in these countries. This, coupled with the gross deposits placed in BIS reporting banks worldwide, provides an estimate of OPEC's investable funds based on publicly available counterparty data.[5]

… is poorly tracked by counterparty data …

While this combination of counterparty data roughly matches the outflow of investable funds from OPEC member countries in the late 1980s and early 1990s, it tracks the surges in these funds during periods of high oil prices far less accurately. Almost 70%, or $486 billion, of cumulative investable funds cannot be identified in the counterparty data in the most recent cycle, compared with 51%, or $103 billion, in the previous one.

Several possible explanations for the current large gap come to mind. First, the available counterparty data do not capture offshore purchases of securities. For example, the estimate of OPEC's cumulative net purchases of US securities based on the TIC data would tend to understate the total to the extent that these securities are purchased in London or other financial centres outside the United States. Second, cross-border investment in regional stock and bond markets is likely to have become a more important outlet for petrodollars than before. Many countries in the Middle East are, by some measures, experiencing an economic boom; the stock market indices in Saudi Arabia, Kuwait and the United Arab Emirates more than quadrupled between end-2001 and end-June 2005. Finally, there is some evidence that petrodollars are being invested more broadly – more diversified geographically and across the asset spectrum – than they once were. For instance, hedge funds and private equity funds, which have experienced large inflows worldwide in recent years but are not required to release information on the positions of their investor base, are one possible home for these investments.

… because of greater diversification

The greater diversification across asset types is evident in the limited counterparty data that are available. For example, a rough estimate of OPEC's cumulative net purchases of long-term US securities can be constructed using

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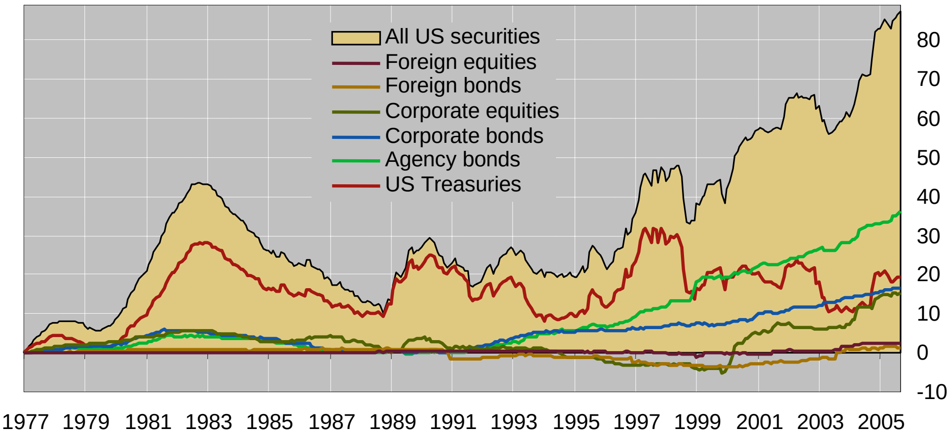
4 Most OPEC member countries' oil industries are at least partially state-owned. See the 2004 OPEC Annual Statistical Bulletin for details.

5 For a description of the US data, see footnote 6. France, Japan and the United Kingdom also provide some information on the geographical breakdown of their international investment position. The stock of OPEC's portfolio investment in France has increased by $25 billion since 2000, the earliest date for which such data are available. Data on OPEC's investment in Japan are available for 2005 only. OPEC investment in the United Kingdom is negligible relative to the other identified investment according to the available data, which cover 1997–2003 (for FDI) and 2001–03 (for portfolio investment). These data, however, underestimate the true OPEC net purchases of securities to the extent that these purchases are conducted through financial intermediaries in third countries.

the US TIC data.[6] This estimate suggests that a smaller share of investable funds has been channelled into US securities in the most recent cycle, even though US securities still constitute the bulk of *identified* investment in foreign securities.[7] At the same time, their investment in German assets rose from 1% to 2% of investable funds across the two cycles. The available data also suggest diversification *within* the universe of US securities. Since 1997, many oil-producing countries have been net sellers of US Treasuries – the asset of choice in the early 1980s – while continuing to move into US corporate and agency bonds (Graph 2.4). Most striking in the current cycle is the increased investment in US equities since 2000, with cumulative net purchases of $15.2 billion.[8]

Estimated net investment in US securities by oil exporters[1]

Cumulative flows since January 1977, in billions of US dollars



[1] The US TIC data provide information on US residents' transactions in long-term securities with counterparties outside the United States. These transactions are broken down by type of security and foreign residence of the counterparty. The estimates are based on net purchases by residents of Venezuela and of those countries classified as "Other Asia", which includes the oil-exporting countries Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates as well as Afghanistan, Bahrain, Bangladesh, Bhutan, Brunei, Cambodia, East Timor, Jordan, North Korea, Laos, Macau, Maldives, Mongolia, Myanmar, Nepal, Sri Lanka, Vietnam and Yemen.

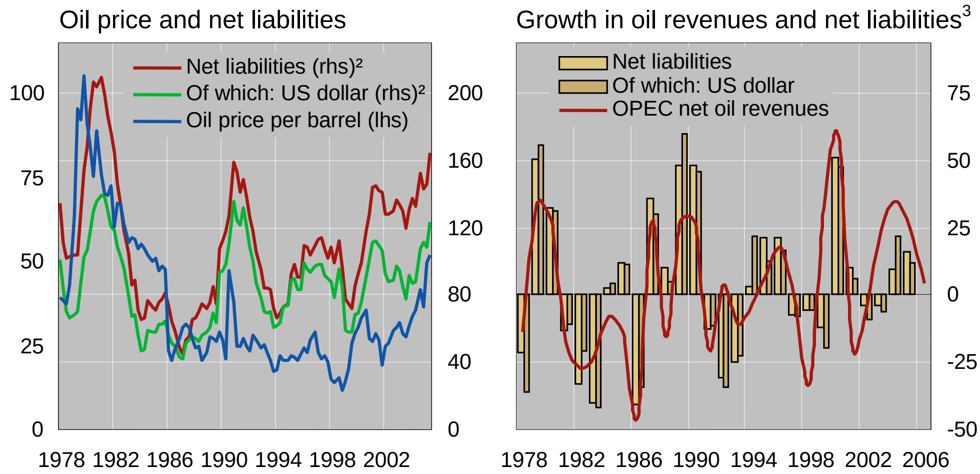
Source: US Treasury. Graph 2.4

[6] The estimate of OPEC's cumulative net purchases of long-term US securities is constructed by adding together cumulative net purchases by residents of Venezuela with cumulative net purchases by residents of countries classified as "Other Asia" in the US TIC (transactions) data (see Graph 2.4). Estimates of the *stock* of securities held by Middle Eastern oil exporters are available in the "Report on Foreign Portfolio Holdings of US Securities as of 30 June, 2004". Their holdings of long-term US securities rose from $19 billion at end-1978 to $45 billion by end-1984. More recently, the outstanding stock rose from $71 billion in March 1994 to $103 billion in June 2004. Their holdings of short-term US debt securities rose as well, from $4.5 billion in June 2002 to $18.4 billion two years later.

[7] These data suggest that roughly 19% of OPEC's cumulative investable funds between 1978 and 1982 were directly channelled into purchases of US securities. In contrast, the same exercise applied to the most recent cycle suggests that only 8% of investable funds cumulated between 1999 and 2004 have been directly channelled into these assets.

[8] In contrast to the observed redistribution of asset holdings within the universe of US securities, OPEC investors have shifted out of German equities and into German government bonds.

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



Note: Data are in real end-March 2005 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 2005 are based on end-March figures and exclude reporting countries which do not provide a currency breakdown. Oil revenues for 2005 and 2006 are estimated.

Sources: EIA; OPEC; BIS. Graph 2.5

Petrodollars are channelled into banks to a lesser degree

This expansion across the asset spectrum has led to a smaller share of investable funds being channelled into BIS reporting banks. Deposits placed in these banks between 1978 and 1982 accounted for 28% of investable funds accumulated over the same period, but only 20% of the cumulated funds between 1999 and 2005. As discussed in the next section, petrodollars are still an important source of funds for the international banking system, although less so than in previous decades.

Petrodollars as a source of funds for BIS reporting banks

Historically, surplus oil revenue during periods of rapid growth was first deposited in banks abroad, and later reinvested in securities or other assets. Thus, 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. As shown in Graph 2.5 (left-hand panel), 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.

OPEC was a large supplier of funds to banks in the previous cycle …

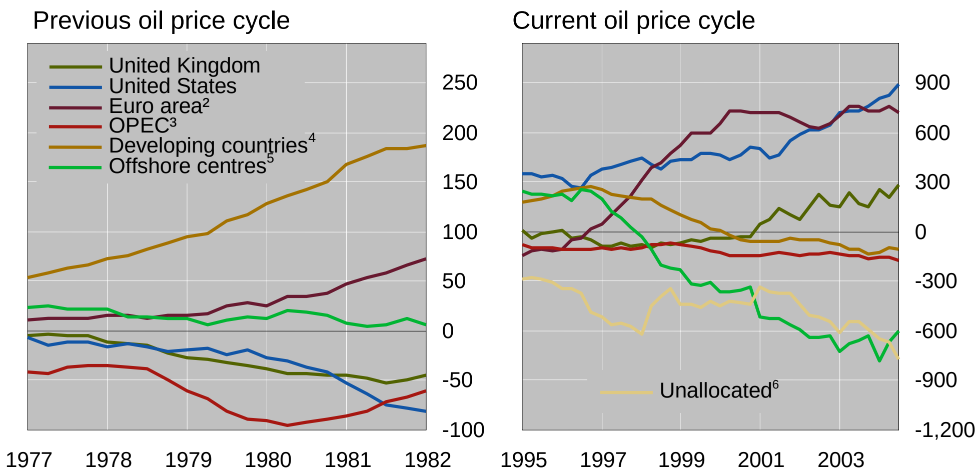
The importance of petrodollars is relatively clear in the 1978–82 cycle (Graph 2.6, left-hand panel). BIS reporting banks' net liabilities to OPEC member countries roughly doubled over this period, making OPEC countries one of the largest net suppliers of funds to the international banking system. Funds from these oil-producing countries fuelled the growth in BIS reporting banks' net long positions elsewhere, in particular vis-à-vis emerging economies, which eventually culminated in the 1980s debt crisis.

Since this earlier cycle, significant changes in global financial flows have reduced the relative influence of petrodollars on the supply of funds flowing through banks. The most striking change, as shown in Graph 2.6, is that BIS reporting banks currently have much larger net short (liability) positions vis-à-vis *offshore centres* and *non-OPEC emerging economies*, and net long (asset) positions vis-à-vis the United States and the euro area, than they did previously.[9] In both cases, the 1997 Asian financial crisis seems to have been a contributing factor. Prior to the crisis, Asia-Pacific was a large net debtor region. However, since 1999, a portion of the combined funds generated from current account surpluses (cumulative $599 billion) and capital inflows into the (major) emerging Asian economies[10] has been placed as deposits in BIS reporting banks. This rise in deposits, coupled with a drop in cross-border credit from BIS banks since 1997, has led to a reversal in the net claim position of BIS reporting banks vis-à-vis emerging economies. Specifically, the stock of BIS reporting banks' net claims on borrowers in emerging Asia fell from $220 billion in the second quarter of 1997 to –$97 billion four years later.[11]

… but less so in the current cycle

Net claims of BIS reporting banks, by vis-à-vis region[1]

In billions of US dollars



[1] Net claims equal the stock of total claims minus the stock of total liabilities. [2] Excluding intra-euro area net claims. [3] Excluding Indonesia. [4] Excluding OPEC countries. [5] Excluding intra-offshore centre net claims. [6] Unallocated liabilities of BIS reporting banks have been allocated to individual vis-à-vis regions to the extent that these liabilities correspond to debt security assets of other BIS reporting banks. The remaining unallocated liabilities drive the plotted series of unallocated net claims. Graph 2.6

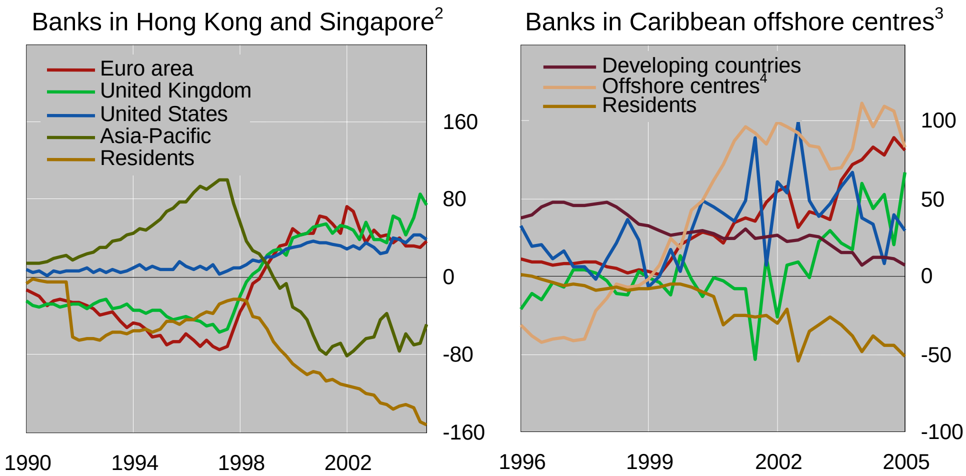
[9] The figures used in the right-hand panel of this graph are estimated. A large portion of reporting banks' liabilities is not allocated to a particular country because, unlike *deposit* liabilities, reporting banks often do not know who holds their *debt security* liabilities. BIS reporting banks' liabilities for which the *residence of the counterparty* is unknown have grown to $1.96 trillion, or 10% of reporting banks' total liabilities (from 2% in 1983). However, data on BIS reporting banks' debt security *claims on banks* are used to reallocate much of these unallocated claims by vis-à-vis country.

[10] These developments were discussed in the international banking markets chapter of the September 2005 *BIS Quarterly Review*. The major emerging market economies in Asia-Pacific include China, India, Indonesia, Korea, Malaysia, the Philippines, Thailand and Taiwan (China).

[11] More recently, in the fourth quarter of 2003, BIS reporting banks' net claims on Latin America turned negative as well.

Net claims of banks in offshore centres, by vis-à-vis region[1]

In billions of US dollars



[1] Net claims equal the stock of total claims minus the stock of total liabilities. [2] Aggregate net positions of banks located in Hong Kong and Singapore. [3] Aggregate net positions of banks located in the Bahamas, Bermuda, the Cayman Islands and the Netherlands Antilles. [4] Excluding intra-Caribbean offshore centre net claims.

Source: BIS. Graph 2.7

The effects of the Asian crisis are also evident in reporting banks' positions vis-à-vis offshore centres. The large fall in Graph 2.6 reflects a shift from a net long to a net short position vis-à-vis residents of Hong Kong and Singapore. From a reporting country perspective, banks located in these areas cut back credit to borrowers in Asia-Pacific, and became a conduit through which net funds from the region – and net funds from residents of Hong Kong and Singapore – were channelled to banks in the United Kingdom and the euro area. This reflects the role of Hong Kong and Singapore as international funding centres. The fall in BIS reporting banks' net claims on offshore centres in Graph 2.6 also reflects a drop vis-à-vis residents of Caribbean offshore centres. In part, this is a result of larger net long positions of banks located in these areas vis-à-vis the euro area, the United States and the United Kingdom since 1999 (Graph 2.7, right-hand panel).

OPEC's deposits with BIS reporting banks

Even as oil exporters have become a relatively smaller source of funds for BIS reporting banks, it is clear that their gross deposits placed in reporting banks have been on the rise over the last year. Total liabilities of BIS reporting banks to these countries have grown at an average annual rate of 20% since the first quarter of 2004, reaching $611 billion in the most recent quarter (Graph 2.8, left-hand panel). Despite this growth, however, residents of oil-exporting countries account for only 3% of BIS reporting banks' total deposit liabilities, down from a high of 13% during the previous oil price cycle. This drop is even more significant if interbank deposits, which can swell or contract as funds are passed between banks, are excluded.

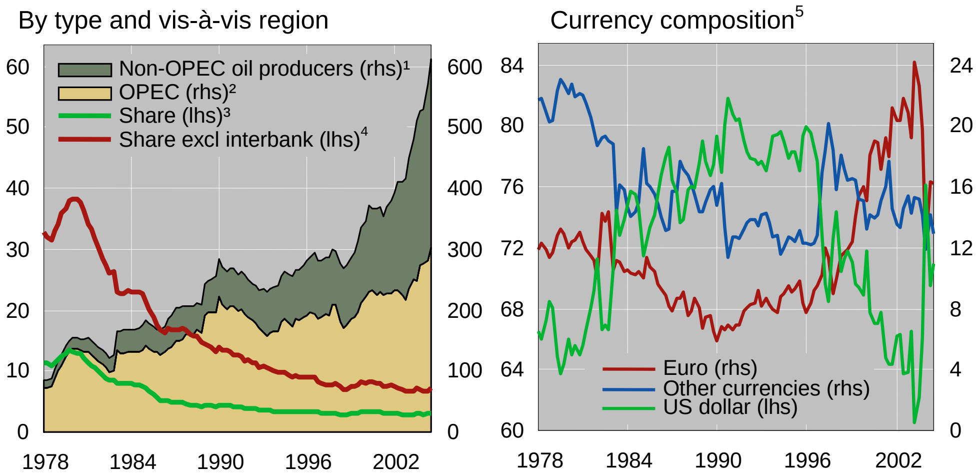
As Graph 2.8 shows, non-OPEC oil-exporting countries account for a larger share of these "petro-deposits" with BIS reporting banks than they once did.[12] This primarily reflects Russia's oil revenues, which have totalled $403 billion since end-1998, second only to Saudi Arabia's $597 billion over the same period. Russia's oil revenues have underpinned its accumulation of foreign exchange reserves and robust foreign placement of funds. A portion of these funds have been channelled into foreign banks. Specifically, deposits in BIS reporting banks have accounted for 38% of the $250 billion rise in Russia's total foreign financial assets over the current oil price cycle.

Non-OPEC oil exporters have grown in importance relative to OPEC

The currency composition of OPEC deposits in BIS reporting banks has undergone noticeable changes since 1999. These changes seem to be related to the evolution of the euro/US dollar exchange rate as well as interest rate differentials. OPEC deposits shifted towards the euro from early 1999 to early 2004 (Graph 2.8, right-hand panel), accompanied by a rise in the euro/US dollar interest differential over the first three years of that period, and a sharp depreciation of the dollar against the euro over the last two.[13] By the beginning of 2004, the share of euro-denominated deposits in total OPEC currency-adjusted deposits had risen by 13 percentage points. However, this quickly reversed as the euro/dollar exchange rate stabilised and policy rates in the United States started to rise. Between mid-2004 and the second quarter of 2005, new US dollar-denominated deposits placed by OPEC residents in BIS reporting banks led to a decline in the euro share by 8 percentage points.

Currency composition of OPEC deposits …

BIS reporting banks' total liabilities to major oil-exporting countries



[1] Angola, Egypt, Mexico, Norway, Oman and Russia; in billions of US dollars. [2] Excluding Indonesia; in billions of US dollars. [3] As a share of total deposit liabilities of BIS reporting banks. [4] As a share of total deposit liabilities of BIS reporting banks, excluding interbank liabilities vis-à-vis developed countries and offshore centres. [5] Currency shares in the total stock of liabilities vis-à-vis OPEC countries. These stocks are adjusted for valuation effects using constant 2005 Q2 exchange rates. Graph 2.8

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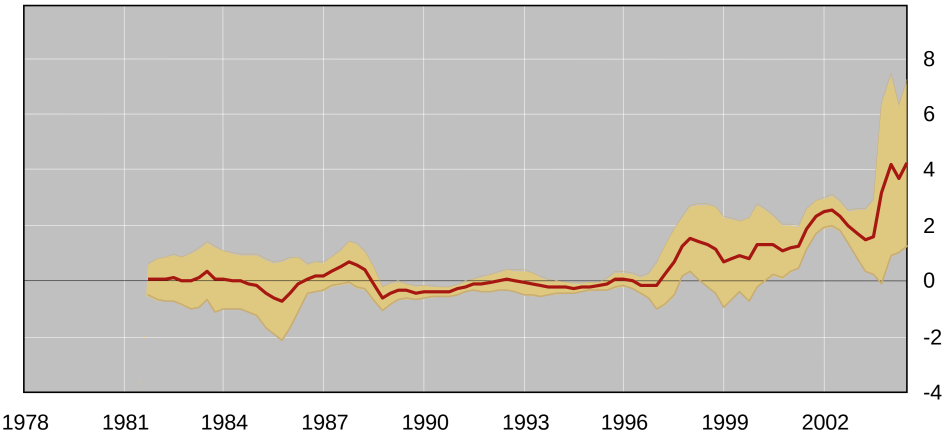
[12] The share of total deposit liabilities to oil-exporting countries, as defined in graph 2.8, accounted for by non-OPEC members rose from 14% at end-1977 to 50% in the second quarter of 2005.

[13] Throughout this exercise, exchange rate valuation effects are removed by recalculating the currency share on constant 2005 Q2 end-of-period exchange rates.

Explaining the currency composition of OPEC[1] deposits

The impact of relative euro/US dollar yields[2]



[1] Excluding Indonesia. [2] Results from a 16-quarter rolling regression of the relative euro/US dollar share in OPEC residents' deposits in BIS reporting banks on the contemporaneous euro/US dollar interest rate differential and euro/US dollar exchange rate. The relative currency share equals the stock of euro-denominated deposits as a fraction of the sum of euro- and US dollar-denominated deposits placed in currency reporting countries. These deposit stocks are adjusted using constant 2005 Q2 exchange rates. The interest rate differential equals the difference between German and US one-year annualised government security yields. Deutsche mark/US dollar exchange rates are used prior to 1999. The line plots the slope coefficient of the interest rate differential. The shaded area indicates the two standard error confidence band.

Graph 2.9

This recent reshuffling of deposits across currencies appears similar to, albeit more pronounced than, that observed during the 1978–82 oil price cycle. There is evidence that the currency composition of OPEC deposits in BIS reporting banks has recently been more sensitive to changes in interest rate differentials than in the past. This is implied by the results of a 16-quarter rolling regression of the relative euro/US dollar share in OPEC deposits on the euro/US dollar interest rate and exchange rate differentials (Graph 2.9).

… seems to react to interest rate differentials

The regression is designed to capture the extent to which the currency composition of OPEC deposits reacts to changes in interest rates, given expectations of currency movements.[14] These expectations are assumed to be driven by the contemporaneous interest differential and exchange rate.[15] Since the currency shares are based on deposit stocks valued at a constant exchange rate, the regression captures changes in these shares which result only from new deposit flows.

The regression results provide evidence that the currency composition of OPEC deposits has reacted to the euro/US dollar interest differential only during the recent hike in oil prices. The coefficient on the interest differential is positive and statistically significant in all regression windows (save one) with an

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[14] It should be kept in mind that the regression results are based only on deposits in BIS reporting banks and, thus, need not be valid for all cross-border investments of OPEC residents. In addition, the regression results provide on their own an incomplete picture of the market risk associated with OPEC deposits, which may be hedged.

[15] The euro/US dollar interest rate differentials and exchange rates do exhibit predictive power for actual changes in the euro/US dollar exchange rate between 1978 Q4 and 2005 Q2.

end date from the first quarter of 2001 onwards. During this period, the results have economic significance as well, implying that a 1 percentage point increase in the euro/US dollar interest differential tends to be associated with roughly a 2 percentage point increase in the relative share of euro-denominated deposits.[16]

This same relationship is not apparent in the earlier oil price cycle. The regression results suggest that, before 2001, the currency composition of OPEC deposits was insensitive to relative returns in either statistical or economic terms. Specifically, the high volatility of the euro/US dollar interest differential between 1978 and 1982 was not reflected in movements in the currency shares of deposits.

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[16] The slope coefficient of the exchange rate is statistically significant in most of the regression windows but its sign is unstable. For example, the coefficient is positive in regression windows with end dates between 1998 Q1 and 2002 Q2 and negative in regression windows with end dates between 2003 Q2 and 2004 Q2. The former result is consistent with perceived mean reversion in the euro/US dollar exchange rate, whereby a depreciation of the euro (ie a higher exchange rate) is expected to foreshadow an appreciation and triggers a shift into euros. The latter result is consistent with perceived persistence in exchange rate changes.

Developments in the syndicated loan market

Blaise Gadanecz

Market conditions remain favourable in the third quarter of 2005

After a very strong second quarter, activity in the international market for syndicated loans slowed down. New signings totalled $522 billion in the third quarter, a 28% decrease from the previous period, but 13% higher than in the same quarter last year. On a seasonally adjusted basis, signings dropped by only 5%.

Market conditions remained favourable, especially in the United States, where spreads (unadjusted for credit quality) narrowed further, while average maturities were extended. The percentage of deals that had covenants or guarantees attached was at a record low for industrialised country borrowers, possibly a further indication of easy market conditions.

The low spreads observed on industrial country syndicated loans have been accompanied by a record low number of average participants in such loans: nine institutions per facility. Several banks may have withdrawn from the market because of the low spreads being offered.

Lending to emerging markets totalled $56 billion, a record high not observed since the end of 1997. Activity was driven by exceptionally strong borrowing by the Middle East and Africa and Asia-Pacific regions (in the latter, China in particular). In these two regions, the energy sector was a large recipient of funds and average Libor spreads were low: 76 and 75 basis points, respectively (a level hardly observed in Asia since 1996). South Africa further boosted activity in its region by rolling over $1.5 billion in sovereign facilities. After a long pause, Argentina returned to the market, with an engineering company there arranging a $1.4 billion facility.

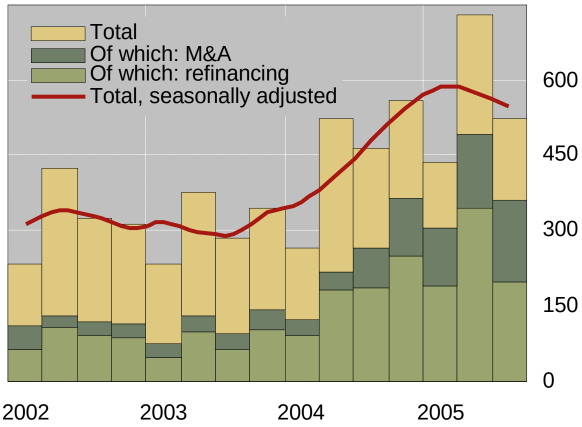
The geography of syndicated lending to selected oil-exporting countries and to the oil industry

The analysis of syndicate structures makes it possible to determine the nationality of banks involved in loan syndications for selected oil-exporting countries and to the oil industry over the past 10 years. This exercise shows that the role of western European banks has been prominent and growing in this area.

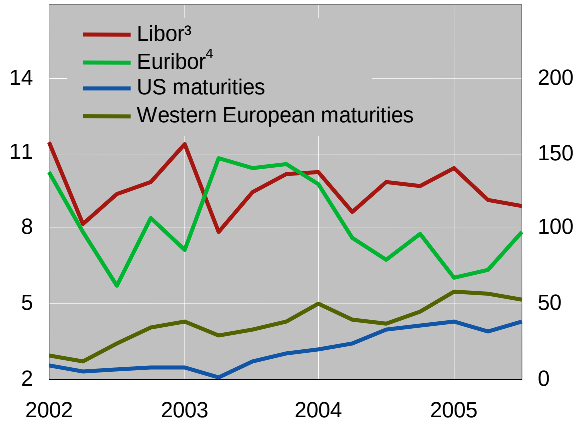
The majority of loans set up over the past 10 years for the OPEC countries of the Middle East (regardless of the industry of the borrower) have been arranged and funded by regional and western European banks (see Graph B). However, the role of regional banks has diminished over time. Indeed, while 30% of these loans had been arranged by banks from the region between 1994 and 1999, this share has dropped during the past five years to 24%, as more banks from

Signings of international syndicated credit facilities

Total signings (USD billions)



Weighted[1] average maturities (years, lhs) and pricing[2] (bp, rhs), United States and western Europe



[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.

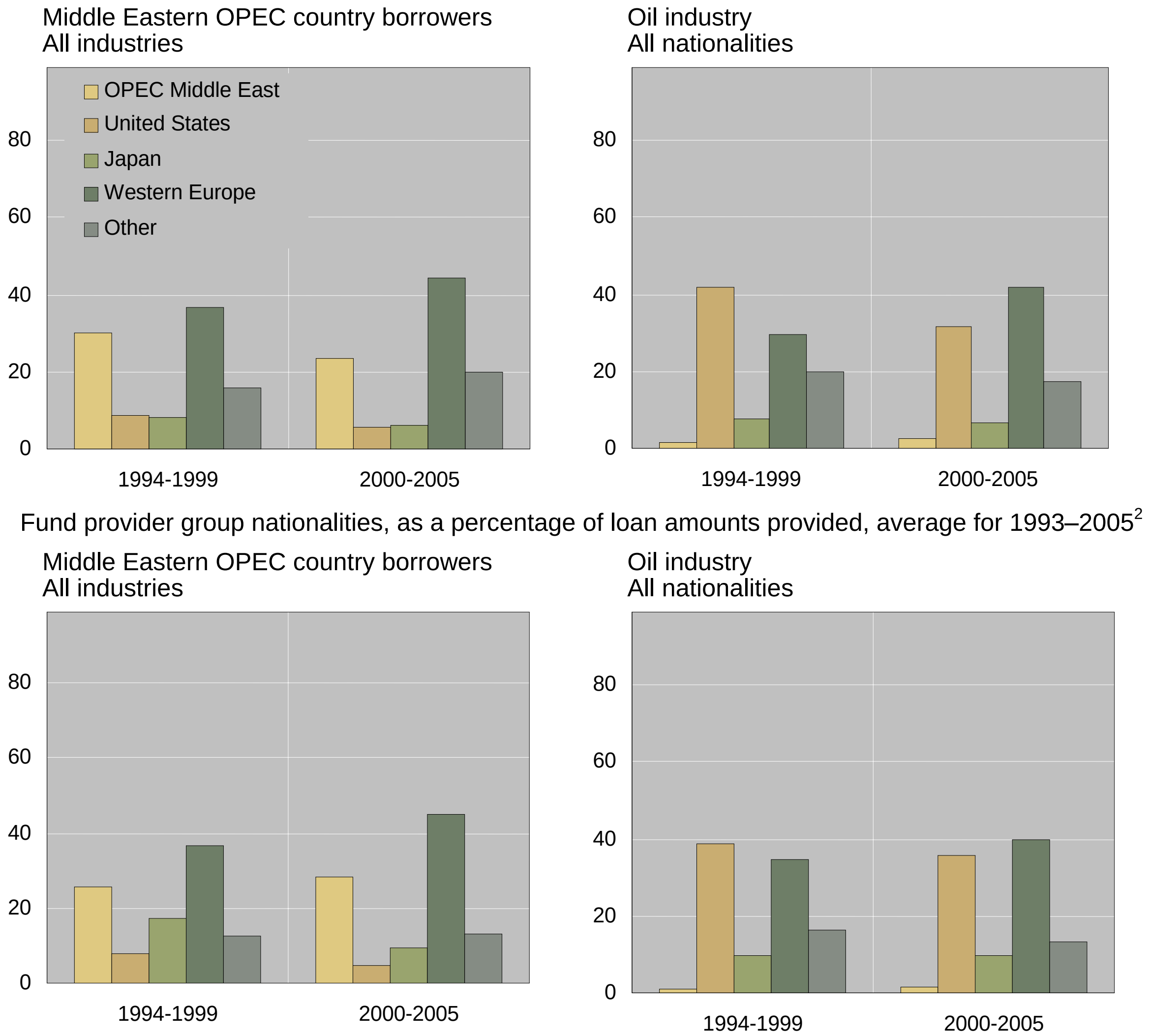
Sources: Dealogic Loanware; BIS. Graph A outside the region, especially from western Europe, have established a presence. Regarding the origin of funds, the share of western European banks has also increased to almost 50% of funds provided in 2004 and 2005, mainly to the detriment of regional lenders. The search for higher returns could have prompted western European banks to diversify their lending activity away from their domestic market, where the pricing of loans has been exceptionally low over the past couple of years.

Western European banks have also been heavily involved in the syndication of trade finance loans for OPEC country borrowers in the Middle East. During the past decade, they have, on average, arranged 56% of such loans and provided 74% of the corresponding funds.

Banks from the United States and western Europe have been the most active in arranging and funding loans for the oil industry worldwide, jointly accounting for more than 70% of the market. Between 1995–99 and 2000–05, western European banks have gained 13 and 5 percentage points of market share as arrangers and funds providers respectively, to the detriment of US institutions.

Geography of oil-related syndicated lending[1]

Arranger group nationalities, as a percentage of number of loans arranged, average for 1993–2005[2]



[1] Including domestic deals. [2] 2005 up to Q3.

Sources: Dealogic Loanware; author's calculations. Graph B