

2. The international banking market

A remarkable surge of interbank activity in the fourth quarter of 2000 capped a near-record year in the international banking market. According to the locational banking statistics, cross-border claims increased by \$400 billion, \$302 billion of which comprised interbank lending.¹ Much of this interbank activity was driven by efforts to recycle large inflows from emerging economies to borrowers in the industrial countries. Oil-exporting countries and emerging economies in East Asia were the main sources of funds, while borrowers in the United States were among the principal recipients.

The surge in fourth quarter activity brought the rise in cross-border claims for the year to \$1.2 trillion, a quadrupling over 1999 levels and only slightly below 1997 levels. This headline figure is inflated by interbank activity, which is typically characterised by a multiplier process. Loans to non-bank borrowers actually slowed in 2000, to \$55 billion from \$107 billion in 1999. Cross-border purchases of securities continued their upward trend, driven by a sixfold increase in purchases of securities issued by US residents. By the end of 2000, securities accounted for 23% of banks' outstanding cross-border claims, up from 15% in 1997.

Purchases of securities were a bright spot in what was otherwise another year of subdued international bank flows to emerging economies. Supported by foreign banks' acquisitions of local financial institutions, especially Latin American banks, securities flows rose to \$26 billion in 2000 from \$6 billion the previous year. However, loans to emerging economies, in particular to Asia, continued to contract, by \$36 billion. Even though total claims contracted at a much slower pace than in previous years, net outflows from emerging economies to international banks during 2000 exceeded average annual outflows during the financial crises of 1997-99 because of large cross-border deposit flows from emerging economies.

¹ The discussion of international bank flows that follows mainly relates to the BIS locational banking statistics, which are based on the residence of reporting banks and adjusted for changes in exchange rates. These data are somewhat different from the BIS consolidated banking statistics, the latest of which were published in a separate BIS press release on 7 May 2001. For an explanation of the differences between the two sets of statistics, see "Introduction to the BIS locational and consolidated international banking statistics" in the Statistical Annex to this publication.

Main features of cross-border claims of BIS reporting banks

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

	1999	2000	1999	2000				Stocks at end-Dec 2000
	Year	Year	Q4	Q1	Q2	Q3	Q4	
Total claims	276.1	1,171.8	125.7	445.1	116.9	210.1	399.7	10,764.4
Interbank loans ¹	-214.3	658.7	- 1.1	285.2	-23.4	94.7	302.2	6,262.8
Loans to non-banks	106.7	55.0	34.4	26.5	- 1.4	17.7	12.2	2,069.9
Securities ²	383.7	458.0	92.4	133.3	141.8	97.7	85.2	2,431.7
On developed countries	467.6	1,114.1	112.9	486.1	116.8	177.7	333.5	8,394.2
of which: <i>intra-euro</i> ³	258.7	140.7	- 1.7	108.1	-13.5	26.2	19.8	1,573.4
Interbank loans ¹	33.4	674.9	- 0.5	337.6	8.4	86.1	242.8	4,990.5
Loans to non-banks	117.0	69.1	39.6	41.5	-13.2	23.5	17.4	1,395.1
Securities ²	317.2	370.1	73.9	107.0	121.7	68.2	73.2	2,008.6
On offshore centres	-102.6	50.4	32.0	-50.1	5.5	27.5	67.5	1,257.6
Interbank loans ¹	-139.7	- 18.8	35.9	-63.5	-17.6	13.6	48.6	843.3
Loans to non-banks	9.3	18.4	-11.0	- 0.9	12.6	- 2.0	8.7	247.0
Securities ²	27.7	50.8	7.1	14.3	10.4	15.8	10.3	167.3
On emerging economies	- 69.1	- 10.0	- 6.3	1.3	- 3.8	- 1.3	- 6.3	905.5
Interbank loans ¹	- 58.6	- 8.9	- 6.7	6.1	- 9.9	- 6.9	1.9	354.1
Loans to non-banks	- 16.6	- 27.5	- 2.9	-16.2	- 0.1	- 0.5	-10.7	399.2
Securities ²	6.1	26.3	3.3	11.4	6.3	6.2	2.5	152.1
Unallocated claims	- 19.8	17.3	-12.9	7.7	- 1.6	6.1	5.0	207.2
<i>Memo: Syndicated credits</i> ⁴	1,025.9	1,465.7	286.2	261.8	373.9	424.3	405.7	

¹ Including inter-office transactions. ² Partly estimated. The data comprise mainly debt securities, but also include other assets, which account for less than 5% of total claims outstanding. ³ Cross-border claims of reporting banks in the euro area on residents of the euro area. ⁴ Signed new facilities.

Sources: Capital DATA; BIS locational banking statistics.

Table 2.1

Interbank activity surges

The fourth quarter of 2000 saw a marked expansion of interbank balance sheets. Cross-border lending to banks in developed countries and offshore centres rose by \$291 billion, and interbank liabilities increased by an equally large amount (Table 2.1). The surge in interbank activity in the fourth quarter was similar in magnitude to those observed in the final quarter of 1997 and the first quarter of 2000.

Marked expansion of interbank balance sheets ...

In terms of net interbank flows, in the fourth quarter banks in the United Kingdom, Japan and France were the largest recipients and banks in offshore centres and the United States the proximate sources. These net flows are typically only a fraction of the change in interbank assets, since the process of distributing wholesale funds to other banks builds up both assets and liabilities on the balance sheet. Banks in the Cayman Islands, Hong Kong and the United States channelled funds to the United Kingdom, from where interbank funds were redistributed to banks in the euro area and Japan. Banks in Japan also received large transfers from the euro area and Singapore, while banks in the euro area, especially France, received funds from the United States. The sequencing of flows was further complicated by large transactions between

Swiss banks and their subsidiaries in Japan and the United States, and between US banks and their offices in the Cayman Islands.

Large deposit flows from emerging economies

Whereas the 1997 expansion of interbank activity had been driven by an effort to recycle large repayment flows from borrowers in Asia, and that of the first quarter of 2000 by demand for financing by non-bank borrowers in the euro area, the latest increase appears to reflect, at least in part, the recycling of large deposit flows from emerging economies. Emerging economies deposited \$28 billion with international banks in the fourth quarter, bringing total deposits for 2000 to \$145 billion. This represents a near fivefold increase over deposit flows in 1999. As a percentage of emerging economies' GDP, 2000 saw the largest deposit flows (2%) since 1979-80, when oil-exporting countries placed windfall revenues with international banks.

... driven by deposits from emerging economies

Deposit flows from Taiwan, China (henceforth referred to as Taiwan) increased sharply towards the end of 2000. In the first half of the year, there had been little change in reporting banks' liabilities vis-à-vis Taiwan (Table 2.2). However, in the second half, residents placed over \$19 billion with international banks, of which \$12.6 billion in the fourth quarter. Most of these funds were denominated in US dollars and deposited with banks in offshore centres and the United States. Notably, over three quarters of these funds came from banks, rather than corporations and other non-bank entities. Non-banks in Taiwan stepped up their purchases of foreign currency last year, but instead of investing offshore they deposited these funds in the local financial system. Local banks then placed excess foreign exchange with international banks. Non-banks' preference for onshore accounts suggests that neither political risk nor the credit risk of local banks was a significant motivation for the increase in cross-border deposits.

Deposits by Taiwan accelerate

Interest rate differentials and weak demand for foreign currency loans explain continued deposit flows from mainland China.² Residents of the mainland, again predominantly banks, placed \$8.1 billion with international banks in the fourth quarter, and \$35.8 billion in 2000 as a whole (25% of total deposits by emerging economies). A little more than half of the deposits in the fourth quarter were denominated in Hong Kong dollars. For the year as a whole, however, the US dollar was the currency of choice. China placed virtually all of its deposits with banks in offshore centres and Europe.

Continued deposit flows from mainland China ...

After China and Taiwan, oil-exporting countries were the most important source of deposit flows in 2000. OPEC member countries deposited \$9 billion with banks in the reporting area in the fourth quarter, and \$38 billion in the

... and OPEC members

² For a discussion of the growth of foreign currency deposits in the Chinese banking system, see the special feature by R N McCauley and Y K Mo, "Foreign currency deposits of firms and individuals with banks in China", in the August 2000 issue of the *BIS Quarterly Review*.

Banks' external positions vis-à-vis emerging economies

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

	1999	2000	1999	2000				Stocks at end-Dec 2000
	Year	Year	Q4	Q1	Q2	Q3	Q4	
Total claims	- 69.1	- 10.0	- 6.3	1.3	- 3.8	- 1.3	- 6.3	905.5
Africa & Middle East	0.2	- 7.7	5.2	- 6.3	- 1.0	- 1.4	1.0	151.8
Saudi Arabia	2.0	0.0	0.9	- 1.2	- 0.1	0.1	1.3	26.2
Asia & Pacific	- 61.9	- 28.6	- 19.9	3.0	- 7.3	- 6.0	- 18.3	284.8
Mainland China	- 17.1	- 5.3	- 5.7	0.1	- 3.4	- 1.5	- 0.5	59.8
Taiwan, China	- 3.3	- 3.9	0.7	1.3	- 0.1	- 0.8	- 4.3	15.4
Europe	8.9	12.2	4.9	- 0.4	2.6	1.8	8.3	173.8
Russia	- 6.5	- 6.6	- 1.3	- 1.4	- 1.4	- 3.2	- 0.6	36.0
Turkey	5.8	11.4	1.4	2.7	2.7	2.6	3.4	49.5
Latin America	- 16.2	14.0	3.5	5.0	2.0	4.4	2.7	295.2
Argentina	0.6	1.3	1.0	- 1.2	- 0.1	2.4	0.2	49.1
Brazil	- 8.9	10.0	3.2	1.5	0.1	3.8	4.6	96.3
Total liabilities ¹	31.8	145.1	27.8	42.2	20.7	53.9	28.2	1,051.0
Africa & Middle East	- 6.8	47.8	16.7	7.6	8.4	21.7	10.1	315.4
Saudi Arabia	- 17.9	10.8	1.2	- 0.4	- 0.9	7.2	4.9	60.1
Asia & Pacific	4.9	65.8	- 0.6	26.6	9.5	12.8	16.9	360.0
Mainland China	- 3.9	35.8	- 0.1	12.0	10.4	5.3	8.1	102.3
Taiwan, China	7.5	19.6	2.8	0.0	0.6	6.5	12.6	64.6
Europe	20.3	21.0	7.3	1.8	4.9	9.2	5.1	123.6
Russia	3.8	7.3	0.8	2.4	3.4	3.2	- 1.8	23.4
Turkey	3.3	2.3	2.0	0.0	- 0.6	0.3	2.6	20.7
Latin America	13.4	10.6	4.4	6.2	- 2.1	10.2	- 3.7	252.1
Argentina	0.1	3.2	3.7	0.4	0.1	3.7	- 1.0	40.9
Brazil	2.2	- 4.1	- 2.6	1.2	- 8.9	2.8	0.7	49.1
Net flows ²	- 100.9	- 155.1	- 34.1	- 40.9	- 24.5	- 55.2	- 34.5	- 145.5
<i>Memo:</i>								
<i>OPEC members' deposits</i>	- 19.8	37.8	13.3	1.9	9.5	18.0	8.5	233.2

¹ Mainly deposits. Other liabilities account for less than 1% of total liabilities outstanding. ² Total claims minus total liabilities.

Source: BIS locational banking statistics.

Table 2.2

whole of 2000 (26% of total deposits). The bulk of these deposits were denominated in US dollars and placed with banks in the United Kingdom. Saudi Arabia and Iran recorded the largest increases among OPEC members, \$10.8 billion and \$8.1 billion, respectively, during 2000. Among non-OPEC oil-exporting countries, Mexico and Russia were the largest depositors, placing \$7.1 billion and \$7.3 billion, respectively. Both Mexico and Russia withdrew funds in the fourth quarter.

Central banks' growing reserves do not explain the large deposit flows

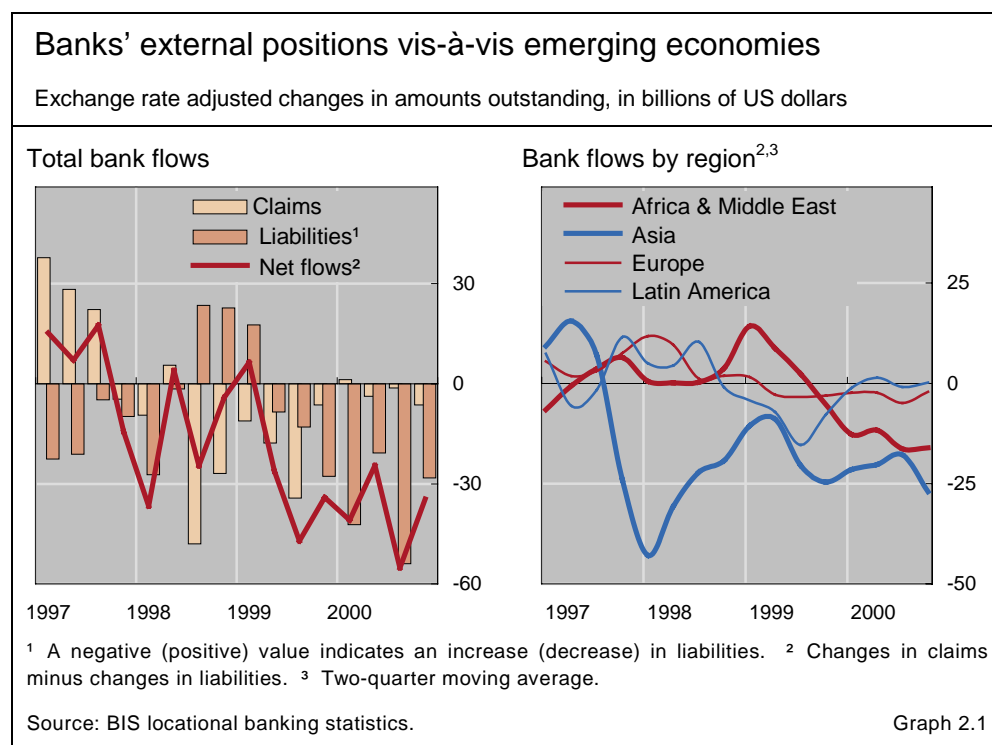
Central banks do not seem to have been major contributors to deposit flows from emerging economies. The foreign exchange reserves of emerging economy central banks increased by \$76 billion in 2000, and it may at first sight seem plausible that this increase was behind the large deposit flows to

banks in the reporting area.³ However, the available evidence does not support this link. Cross-border flows from official monetary institutions – mainly central banks – to banks in the reporting area slowed to \$43 billion in 2000 from \$60 billion in 1999. These flows include deposits by central banks worldwide, and so withdrawals by industrial country central banks could conceivably have offset deposits by emerging economy central banks. But this is unlikely to have been the case given that the reserves of industrial country central banks also increased in 2000, by \$55 billion.⁴

Claims on emerging economies fall again

Unlike the experience of the 1970s, recent deposit flows from emerging economies were not recycled back to them. Taking into account changes in both assets and liabilities, Latin America was the only emerging region which was a net recipient of bank flows in 2000 (Graph 2.1). Even then, at \$3 billion, these outpace new borrowing from international banks, as large current account surpluses obviated the need for external financing. Bank investment in

Net outflows from all emerging regions except Latin America



³ Liabilities vis-à-vis banks in emerging economies increased by \$123 billion in 2000. In the BIS locational banking statistics, bank counterparties include central banks as well as commercial banks. Banks in the reporting area report a global figure for their liabilities to official monetary institutions, with a currency breakdown but no country breakdown (see Table 5C in the Statistical Annex).

⁴ For a discussion of the instrument composition of central banks' US dollar reserves, see B Fung and R N McCauley, "Composition of US dollar foreign exchange reserves by instrument", in the November 2000 issue of the *BIS Quarterly Review*, pp 59-60.

Brazil and Turkey receive the bulk of new credit

Latin America remained concentrated in Brazil in the fourth quarter. Claims on Brazil increased by \$4.6 billion (Table 2.2), owing principally to the purchase of Banespa, a state bank privatised in November, by Banco Santander Central Hispano of Spain. Over half of the \$10 billion rise in claims on Brazil in 2000 was related to foreign acquisitions of Brazilian banks. Foreign banks lent \$1.1 billion to Argentina in the fourth quarter, but largely offset this increase by selling \$0.9 billion worth of Argentine securities. Banks also reduced their holdings of Mexican securities, contributing to a \$3.9 billion decline in claims on Mexico in the fourth quarter.

In emerging Europe, Turkey was by far the largest recipient of bank flows. Indeed, during 2000, cross-border claims on Turkey increased by more than claims on any other emerging economy: \$11.4 billion. In the fourth quarter alone, banks lent \$3.4 billion to Turkey. Two thirds of the fourth quarter amount took the form of loans to non-banks, mainly project financing and lending to the central government. The remainder was lent to banks, despite the emergence of strains in Turkey's banking system. More recent data on syndicated credits suggest that banks sharply reduced their lending to Turkey in the early part of 2001 (see page 21).

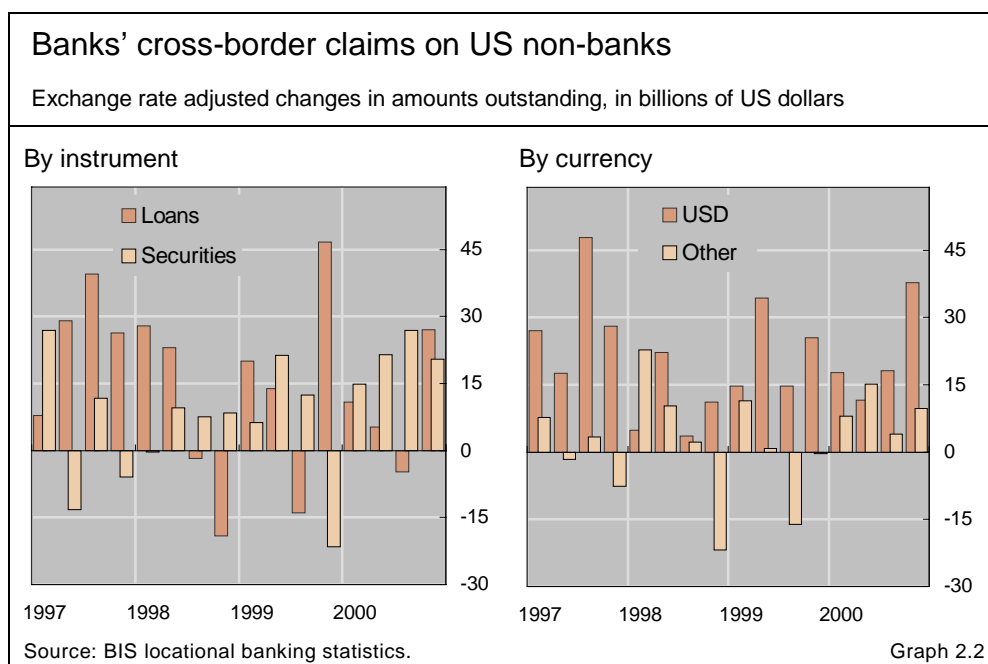
Repayments by Asian borrowers, which appeared to have bottomed out in the first half of 2000, picked up again in the fourth quarter. Bank claims on emerging economies in Asia fell by \$18 billion, bringing the total contraction in claims to \$29 billion in 2000. At first glance, this appears to represent a significantly slower pace of outflows than in 1999, when claims fell by \$62 billion. But once changes in deposits are taken into account, net outflows from emerging economies in Asia to banks in the reporting area actually increased in 2000, to \$94 billion from \$67 billion in 1999.

Korea and Taiwan experience large contractions in claims

A \$9.2 billion contraction in loans to Korean borrowers accounted for half of the decline in claims on Asian borrowers in the fourth quarter. Earlier in 2000, banks in the United States had engaged in reverse repos with borrowers in Korea, and the fourth quarter decline in claims arose in part from the unwinding of these agreements. Cross-border claims on residents of Taiwan fell by \$4.3 billion in the fourth quarter, the largest such decline ever recorded. The rapid growth of foreign currency deposits in the local financial system reduced local banks' demand for foreign currency loans from abroad. Also, greater international attention had been given to the soundness of the Taiwanese financial system during 2000, leading many foreign banks to reduce their exposure.

Funds channelled into the United States

Instead of being channelled into emerging economies, funds made available through the interbank market supported an increase in lending to non-bank borrowers in the industrial countries, especially in the United States. Banks in the reporting area also continued to invest substantial sums in securities issued by US and European borrowers.



After several weak quarters, loans to non-banks in the United States increased by \$27 billion in the fourth quarter of 2000 (Graph 2.2). Seasonal factors were partly responsible for this increase; corporate issuance of commercial paper in the United States usually declines towards the end of the year, and issuers turn instead to their backup credit lines with banks. Lending was also boosted by demand from US telecommunications firms, which raised \$38 billion in the international syndicated credit market in the fourth quarter.

CP issuers and telecoms in the United States turn to banks

Even while stepping up their direct lending, international banks continued to purchase large amounts of securities issued by US residents. As a result, cross-border flows – securities purchases plus lending – to non-bank borrowers in the United States increased by 43% between 1999 and 2000, to \$121.8 billion. Surprisingly, 30% of these flows were denominated in currencies other than the US dollar. US entities, including US agencies, increased their issuance of euro-denominated bonds in 2000, and this helped to boost euro-denominated flows from international banks to US non-banks to \$16.2 billion last year from zero in 1999. Yen-denominated flows rose to \$9.8 billion from -\$0.5 billion, perhaps boosted by the desire of US non-banks to take advantage of low yen interest rates.

The locational banking statistics indicate that, during the course of the year, over half of the cross-border flows to US non-banks were provided by banks in the United Kingdom. However, a substantial proportion of these funds were from euro area and Japanese banks resident in the United Kingdom rather than UK-headquartered banks. Based on the consolidated banking statistics, which are compiled on a nationality basis, German banks' consolidated claims on public sector and non-bank private sector borrowers in the United States increased by \$49 billion in 2000. Japanese banks' claims increased by \$41 billion. Japanese banks were especially active buyers of US

German and Japanese banks lead the increase in claims on US non-banks

agency securities. UK banks' consolidated claims on US non-bank borrowers increased by \$15 billion over the same period.

Claims on non-banks in Japan continue to contract

In contrast to the increase in claims on US non-banks, cross-border claims on non-bank borrowers in Japan contracted by \$32.7 billion in the fourth quarter. European banks were responsible for most of this decline.

Japanese banks
unwind loans
booked offshore

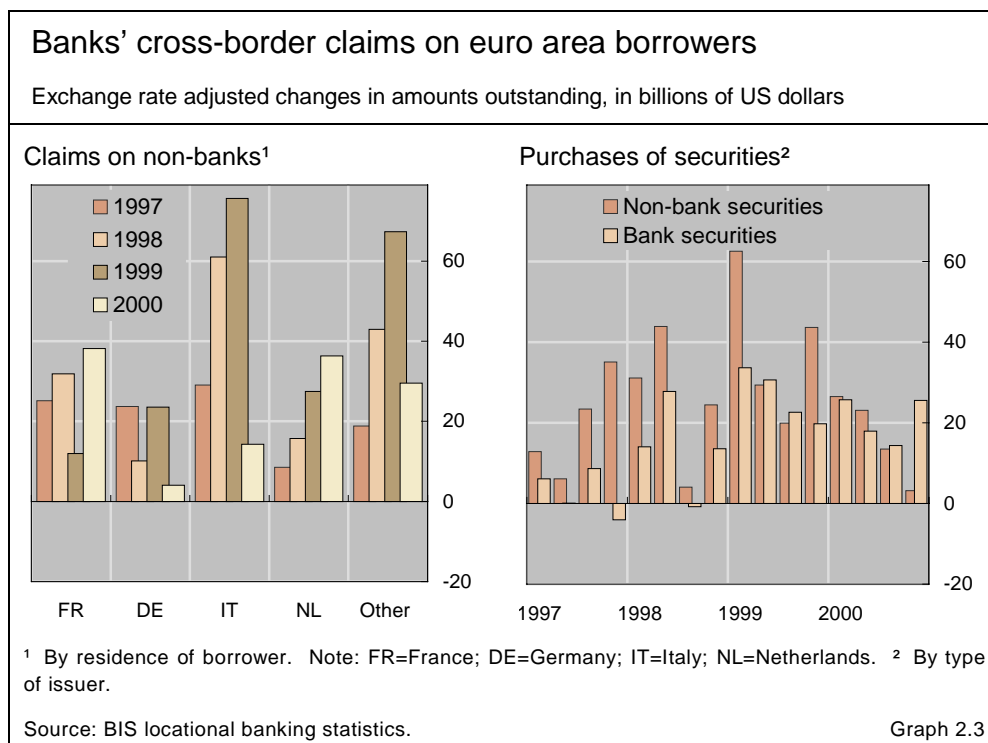
For the year as a whole, credit to non-banks in Japan fell by \$66.9 billion, making 2000 the fifth consecutive year of cutbacks. The key factor behind this contraction was the continued unwinding of loans to Japanese residents booked through Japanese banks' offices in banking centres abroad. Financial stresses in Japan in 1997-98 had led a large number of Japanese banks to close or scale back their operations abroad. In more recent years, the weakness of the Japanese economy lowered corporate funding needs. These changes had a particularly adverse impact on international banking activity in Hong Kong. Between the end of 1997 and the end of 2000, the claims of banks in Hong Kong vis-à-vis non-bank borrowers in Japan fell by 80%, to \$39 billion. Japanese banks' interbank claims on Hong Kong, by which many of the loans were funded, fell in tandem.⁵

Securities issued by euro area non-banks fall out of favour

Banks prefer to buy
lower-risk bank
securities

In the euro area, cross-border flows to non-bank borrowers slowed to \$9.8 billion in the fourth quarter, the smallest flows since the start of monetary union. At least part of this slowdown can be explained by a reduction in investors' appetite for risk. As discussed in the previous issue of the *BIS Quarterly Review*, lower-rated borrowers faced significantly wider credit spreads in the fourth quarter of 2000, and consequently reduced their bond issuance. At the same time, highly rated borrowers retained favourable access to debt securities markets. The locational banking statistics clearly illustrate the shifts in demand that were behind this deterioration in financing conditions. Even while reducing their purchases of corporate bonds and other non-bank securities, which tend to be rated below triple-A, banks in the reporting area increased their cross-border purchases of bank securities (Graph 2.3). In the euro area, many bank securities, such as Pfandbriefe, have top credit ratings, and so are regarded as safe assets.

⁵ For a discussion of international banking activity in Hong Kong, see the box by R N McCauley and Y K Mo, "Recent developments in the international banking business of Hong Kong", in the June 1999 issue of the *BIS Quarterly Review*.



Despite the record amounts raised by euro area telecoms in the international syndicated credit market in 2000, flows to euro area non-banks almost halved in 2000, to \$122 billion from \$206 billion in 1999. Cross-border credit to non-bank borrowers in a few euro area countries, in particular France and the Netherlands, picked up in 2000 (Graph 2.3). Yet the majority of countries saw a moderation of inflows. Italy experienced an especially sharp slowdown, with cross-border claims on non-banks increasing by only \$14.3 billion in 2000, compared to \$75.6 billion in 1999.

Euro area banks were wholly responsible for the slowdown in cross-border flows to euro area non-banks. The introduction of the single currency had effectively relaxed prudential and regulatory controls over currency mismatches, and thereby encouraged financial institutions to diversify their portfolios by investing across the euro area. Consequently, immediately before and after the launch of monetary union, banks had stepped up their cross-border purchases of securities, boosting flows to non-banks in the euro area. This adjustment of portfolios now appears to have run its course.

Cross-border flows to non-banks in the euro area halve in 2000

Syndicated credits: large amounts of telecoms facilities mature in 2001

Blaise Gadanecz

After an exceptionally strong second half of 2000, activity in the international syndicated credit market slowed sharply in the first quarter of 2001: facilities signed fell to \$253 billion from \$406 billion in the fourth quarter of 2000. The first quarter has historically been weak, but even on a seasonally adjusted basis signings dropped by 20%.

Large US corporations were the main drivers of activity in the first quarter. Kellogg and American Home Products each borrowed \$6 billion. Facilities totalling \$6 billion were arranged for Lucent Technologies to help the firm meet its obligations after losing access to the commercial paper (CP) market. The general deterioration in financing conditions in the CP market around the turn of the year, and thus the higher likelihood that issuers would call on their backup lines with commercial banks, led banks to tighten the conditions attached to new standby or CP support facilities. As a result, volumes in this segment of the syndicated credit market slowed to \$15 billion in the first quarter from \$45 billion in each of the two previous quarters.

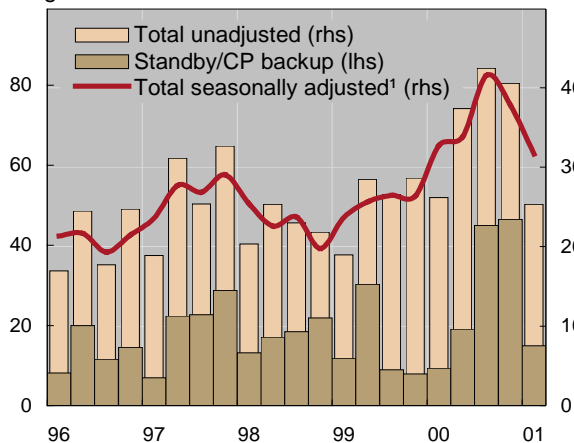
An important factor behind the overall slowdown in activity in the first quarter was the more moderate pace of lending to telecommunications companies. Massive sums had been arranged for telecoms in the second half of 2000, but this activity dropped off in the first quarter. Telecoms instead tapped bond markets (see page 23). Many of the telecoms facilities arranged in 2000 were short-term, and consequently will need to be refinanced in 2001. First quarter activity already reflected the rolling-over of maturing facilities. Pacific Century Cyberworks arranged a \$4.7 billion term loan to refinance part of a facility contracted in early 2000 to fund the purchase of Hong Kong Telecom. Assuming that the facilities previously arranged are fully drawn down and not repaid early, repayments will peak at \$60 billion in the third and fourth quarters of 2001.

Emerging economies raised \$13 billion in the syndicated credit market in the first quarter. Turkey, the largest borrower in 2000, was all but absent from the market. Turkish banks raised \$0.3 billion, down from an average of \$1.4 billion a quarter in 2000, and corporations another \$0.2 billion. Mexico was the largest recipient of funds, obtaining \$2.3 billion. Most of this was raised by CEMEX, a cement manufacturer, to finance an acquisition in the United States.

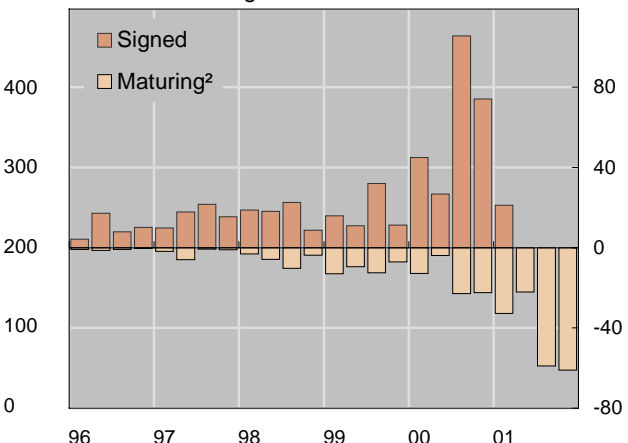
Activity in the international syndicated credit market

In billions of US dollars

Signed facilities



Facilities arranged for telecoms



¹ Adjusted using the US Census Board's X11 Arima seasonal adjustment process. ² Estimated. Maturing facilities are based on facilities signed from January 1993 onwards and assume that the full amount was drawn down and the facility was not repaid early.

Sources: Capital DATA; BIS.