

# European Investment Bank

## Information

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## The International Capital Market in 1984

International borrowing in the form of public issues of international and foreign securities and syndicated bank loans and facilities grew substantially in 1984 after experiencing a partial set-back the preceding year (Table 1). The growth, however, was unevenly distributed between different sectors of the bond market and the market in syndicated credits. While the amounts raised in the dollar sector of the international market and in New York itself in 1984, when converted into ECUs for the purpose of comparison

with capital issues on other markets (see inset on conversion rate), were nearly double those recorded in 1983, internationally syndicated bank credits denominated in dollars continued to decline in spite of an increase in such bank lending in other currencies. Other facilities in the form of stand-by credits and underwriting to cover the issuance of short-term notes increased more rapidly than any other form of financing even after deducting the equivalent of about 30 billion ECUs of backing for mergers.

The increase in 1984 in the proportion of international and foreign issues accounted for by dollar borrowing could be ascribed to a number of factors of which perhaps the most important may have been uncertainty over the direction of interest rate movements. The uncertainty encouraged the resort by borrowers and investors alike to variable rate instruments such as floating rate notes, short-term "euro-notes" backed by medium or long-term underwriting facilities and similarly backed issues of commercial paper in the U.S.A. On the other hand, while there were prospects of prolonged decline in interest rates, issues with warrants entitling holders to purchase further securities at a later date on similar terms gained in popularity.

At the beginning of the year, interest rates were still tending to decline in dollar markets as on others (see graph) but soon began to climb under the influence of strong demand for credit to finance a rapid rise in economic activity in the U.S.A. and the very large and growing deficit in the Federal budget. Reinforcing these influences, as the growth rate of the money supply rose above the upper limit of the official target range, were the forecasts of a number of market analysts that interest rates would reach record highs by the end of 1984 or soon after. The fairly steep upward

movement in interest rates that resulted continued into July when an apparent slowing of economic activity and a slackening of the rate of growth of the money supply induced a slight easing of the stance of monetary policy. In the meanwhile, however, the rise in interest rates on dollar markets together with the brighter prospects offered by investment in U.S. equities strengthened the flow of capital into dollar securities and the dollar itself. As a reflection of the movement of funds into dollar securities, interest rates on other capital markets also rose during the second quarter of the year in spite of the threat that this posed to the somewhat fragile economic recovery in industrialised countries in Europe.

During the second half of 1984, as the slowdown in economic growth in the U.S.A. became more evident, market uncertainties were translated into questions of how far the easing of monetary policy in the U.S.A. would go and how long it would last in view of the need to fund an even larger Federal budget deficit. The decline in interest rates on dollar markets and a temporary and limited reversal of the U.S. dollar's appreciation against other major currencies enabled monetary authorities in Europe and in Japan to bring interest rates downwards, a movement which continued to the end of the year in spite of a fresh strengthening

of the dollar against their respective currencies when President Reagan's re-election in November became virtually certain. Bond yields on major capital markets, as Table 2 shows, consequently ended the year lower than when it began, the largest falls being in markets of EEC currencies and the ECU.

Further factors making for uncertainty in securities markets were introduced by the decision of the U.S. authorities in mid-year to suspend the 30% withholding tax on interest owing on securities held by non-residents. This seemed for a while to threaten the separate existence of the dollar eurobond market until it became clear that investors still preferred the assured anonymity of bearer bonds issued on the international market to other arrangements designed by the U.S. authorities with the same end in view. In consequence an issue launched directly by the U.S. Treasury on the international market was not perhaps as successful as had been hoped. U.S. official entities and private corporations, however, have benefitted from being able to borrow directly on the international market without having to launch their issues through a subsidiary in an offshore tax-haven.

The German and French authorities followed suit by suspending withholding tax in their respective markets, the German suspension being made retroactive to August.

The Japanese authorities did not suspend withholding tax in 1984, although this was expected, but eased eligibility criteria and raised the ceiling on the amount of individual public issues of foreign bonds in Japan (the Samurai market) as from the beginning of the new financial year in October and opened the euroyen market as from the beginning of December to first class private sector borrowers. The easing of access to the euroyen market is reflected in Table 4 in the large increase in the second half of 1984 in Yen issues on the international market. The majority of the borrowers consisted of American corporations reportedly raising Yen for swapping into dollars through Japanese banks.

The growth of the ECU sector of the bond market matched that of the

total of issues of international and foreign securities. The recomposition of the ECU in September 1984 when the Greek drachma was included as the tenth component currency had little impact at the time on bond yields as the market had discounted a fractional rise in such yields in advance. An increase of about 76% in the flow of new issues was absorbed by a widening geographical range of private and institutional investors. In addition to purely euro-issues, new borrowings aimed at investors on specific national markets such as in Italy, Switzerland, Denmark, the Netherlands, the U.S.A. and, at the beginning of 1985, in France were successfully launched. The range of borrowing instruments was also widened to include convertible and non-voting preference shares. The

amount of syndicated credits and note issuance facilities denominated in ECU grew by 267%, more sharply in fact than that of bond issues.

The recourse during 1984 by a substantial number of borrowers, particularly those of higher standing, to note issuance facilities for their requirements in variable rate finance rather than to issues of floating rate notes or borrowing from international banking syndicates has tended to blur the usual demarcation lines between different forms of borrowing activity. The note issuance facilities, which the market is able to offer at lower cost than the earlier forms of variable rate finance, involve the continuing presence of the borrower or his agent in the money market as a seller of short-term paper against the long-term backing of a line of credit or cover from underwriters. Such facilities resemble medium or long-term security issues, on the one hand because of their longer term backing and syndicated credits, on the other because of the lines of credit which they could in certain circumstances be obliged to activate. Excluding the substantial amount of merger-related stand-by lines of credit agreements concluded in 1984 which seem for the most part unlikely to be activated, the establishment of back-up lines of credit rose sharply and made inroads into the sector of internationally syndicated and foreign bank loans which was already suffering from the aftermath of the third world debt crisis. The role of the new financial instruments is described in more detail below.

#### Note

Unless otherwise stated, the statistics of **bond issues** in this article are of public issues with a maturity of three years or more on the international market or of public issues by foreign borrowers on national markets. For the breakdown by period the date of payment is used.

**International issues** are those which are sold through international banking syndicates, usually in more than one market, including markets outside Europe; they include all issues to which special monetary clauses are attached (ECU, EUA, SDR and other multiple-currency issues).

**Foreign bond issues** are those which are sold on a single national market on behalf of non-resident borrowers by financial institutions of the country concerned. The distinction between international and foreign bond issues is no longer clear-cut.

The statistics on **bank loans and other facilities** cover publicised credits and facilities with a maturity of more than one year. They are recorded at the time of signature.

**International bank loans** consist of credits granted by banks — often in the form of an international banking syndicate — out of euro-currency funds. Facilities to back up the issue of other financial instruments are recorded under **other international facilities**.

**Foreign bank loans** cover credits by banks — denominated in the currency of the providing banks' country — to non-resident borrowers.

The classification of **developed** or industrialised and **developing countries** is based on that of the World Bank, i.e., developing countries are mostly those which had an average income per head in 1982 of up to about US\$ 5 500. South Africa and Portugal, however, have been classified as industrialised countries.

For the purpose of comparison, amounts in various currencies and currency units have been converted in the summary tables into ECUs. The rates applied in this article in converting the ECU into the main currency units in use on the international market are as follows:

		US\$	DM	Sfrs	Yen	£
1983	1 ECU	0.911	2.268	1.889	216.0	0.596
1984	1 ECU	0.808	2.239	1.843	189.1	0.589
		Can.\$	Fl	Ffrs		
1982	1 ECU	1.121	2.535	6.732		
1983	1 ECU	1.040	2.522	6.871		

#### The further development of financial techniques

The sharp growth of activity in international capital markets last year can largely be ascribed to the continuing effort on the part of financial intermediaries to adapt to rapid changes in the economic and monetary environment. The wide array of financial instruments offered to the market, in order both to exploit fast changing relationships between borrowers and lenders and to bring together their often contrasting interests, is evidence of this flexibility.

Issues of bonds with warrants and of perpetual floating rate notes gained in popularity and importance in 1984 as did interest rate and currency swap operations and the resort to note issuance facilities. The financing techniques that have been de-

veloped under these broad headings are varied and sometimes complex.

### Issues of bonds with warrants

Broadly held expectations of interest rate declines and, to a lesser extent, of US dollar depreciation, prompted a robust expansion in the volume of eurodollar issues with bond warrants attached, especially in the second half of the year. Warrants, which are options to buy at any time during a specified period newly issued securities with pre-defined characteristics, are not an innovation. Over 1984, however, bond warrants became prominent not only for the large amounts involved (an estimated 7 billion ECUs worth of eurobonds with warrants is believed to have been issued), but also for the remarkable technical evolution they underwent. Basically, the aim was on the one hand to encourage the participation of a wider range of investors through the offer of instruments of a more speculative character, while on the other to allow borrowers to reduce current and prospective borrowing costs by sharing in, or even anticipating, the cost-saving brought about by falling interest rates. To increase the warrants' intrinsic value, the periods for the exercise of options were significantly lengthened, while in a number of cases payment for the "host" bonds was either delayed or to be effected in instalments and distributed over a period of time, in order to reap the benefits of expected market developments.

Borrowers, however, with a view to protecting themselves against the possibility of having to raise financial resources far in excess of their original intentions, tended to insert in the prospectuses of the original bond issues various early redemption clauses, to be activated at the borrower's option in parallel with the exercise of the warrants. The effective limitation of the appreciation potential of the ex-warrant bonds, which often ended up in the portfolios of individual investors, resulted in these securities being traded at sometimes heavy discounts in the secondary market. Coupled with the modest liquidity and the insufficient transparency of the secondary market in the detached warrants, this feature substantially reduced the attractiveness of the bond-with-warrants packages and exerted a dampening influence on the pace of issuing activity in this sector, particularly towards the end of the year.

Though far less flexible and universal instruments than interest rate futures or currency options as hedges for both borrowers and lenders, warrants have a certain operational and conceptual simplicity and could still command significant market interest, especially in Europe. Among the ways currently being explored of rectifying the

above-mentioned secondary market imperfections, is the possible resort to swap operations as the funds obtained through the exercise of the warrants become available.

### Interest rate and currency swaps

Probably to a greater extent than any other financial technique, interest rate and currency swaps were at

**Table 1: Total international financing 1980-1984 through public issues of securities, short-term issuance facilities, merger facilities, internationally syndicated and foreign bank loans.**

	million ECUs				
	1980	1981	1982	1983	1984
International securities	13 312	20 981	43 902	49 959	92 458
Foreign securities	5 833	9 529	14 127	14 805	22 955
<b>Security issues total</b>	<b>19 145</b>	<b>30 510</b>	<b>58 029</b>	<b>64 764</b>	<b>115 413</b>
(of which floating rate notes)	(3 160)	(6 018)	(10 469)	(14 527)	(41 246)
Internationally syndicated and foreign bank loans	58 158	81 577	98 902	73 764	77 274
Other international facilities <sup>(1)</sup>	(2)	45 759	5 426	14 830	68 217
<b>Total bank and bank guaranteed finance</b>	<b>58 158</b>	<b>127 346</b>	<b>104 328</b>	<b>88 594</b>	<b>145 491</b>
<b>GRAND TOTAL</b>	<b>77 303</b>	<b>157 856</b>	<b>162 357</b>	<b>153 358</b>	<b>260 904</b>

<sup>(1)</sup> International bank stand-by credits and underwriting facilities to provide medium/long-term cover for the issuance of short-term notes and (approximately US\$ 50 bn in 1981 and US\$ 26.5 bn in 1984) backing for take-over and merger bids.

<sup>(2)</sup> Not separately recorded and included in internationally syndicated and foreign bank loans.

**Table 2: Secondary bond market yields of international and foreign issues.**

	1983 average	1984 average	1984 January	1984 December
Bonds denominated in:				
US dollars	12.21	12.73	12.32	11.76
Deutsche Mark	7.8	7.8	8.0	7.3
Guilders	8.23	7.94	8.22	7.21
ECUs	12.51	10.95	11.45	10.00
Yen	7.78	7.45	7.46	7.12
Swiss francs	6.10	6.01	6.02	5.91

**Table 3: Total financing through public issues of international and foreign securities and syndicated bank loans and facilities, classified according to borrowers.**

	million ECUs					
	1982	%	1983	%	1984	%
Developed countries	107 301	66.1	103 976	67.8	202 745	77.7
Borrowers in EEC countries (incl. EEC organisations)	36 533	22.5	39 815	26.0	55 332	21.2
Other developed countries	70 768	43.6	64 161	41.8	147 413	56.5
Developing countries	45 942	28.3	38 378	25.0	39 959	15.3
OPEC countries	8 565	5.3	7 694	5.0	4 697	1.8
Other developing countries	37 377	23.0	30 684	20.0	35 262	13.5
Eastern European countries (incl. Comecon organisations)	709	0.4	1 175	0.8	4 199	1.6
Other international organisations	8 196	5.1	8 933	5.8	13 541	5.2
Unallocated	209	0.1	896	0.6	460	0.2
<b>Total</b>	<b>162 357</b>	<b>100.0</b>	<b>153 358</b>	<b>100.0</b>	<b>260 904</b>	<b>100.0</b>

**Table 4: International and foreign security classified according to currency or currency unit, in million ECUs**

Currencies	International issues						Foreign securities						Total							
	1983			1984			1983			1984			1983				1984			
	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	%	1st H.	2nd H.	Total	%
U.S. dollars	21 022	17 822	38 844	28 390	45 265	73 655	1 373	846	2 219*	3 210	2 809	6 019*	22 395	18 668	41 063	63.4	31 600	48 074	79 674	69.0
Deutsche Mark	3 362	1 717	5 079	2 792	2 848	5 640	661	684	1 345	669	872	1 541	4 023	2 401	6 424	9.9	3 461	3 720	7 181	6.2
Pounds sterling	478	1 568	2 046	2 316	3 023	5 339	373	650	1 023	719	977	1 696	851	2 218	3 069	4.7	3 035	4 000	7 035	6.1
Yen	162	162	324	364	1 108	1 472	1 829	1 503	3 332	1 687	3 194	4 881	1 991	1 665	3 656	5.7	2 051	4 302	6 353	5.5
Swiss francs	—	—	—	—	—	—	2 708	2 828	5 536	3 082	2 772	5 854	2 708	2 828	5 536	8.6	3 082	2 772	5 854	5.1
Canadian dollars	513	669	1 182	474	1 860	2 334	—	—	—	—	—	—	513	669	1 182	1.8	474	1 860	2 334	2.0
Guilders	128	103	231	85	171	256	466	430	896	325	762	1 087	594	533	1 127	1.7	410	933	1 343	1.2
French francs	—	—	—	—	—	—	212	—	212	175	—	175	212	—	212	0.3	175	—	175	0.2
ECUs	900	1 030	1 930	1 728	1 471	3 199	—	—	—	—	200	200	900	1 030	1 930	3.0	1 728	1 671	3 399	2.9
Other currencies/currency units	29	294	323	280	283	563	190	52	242	279	1 223	1 502	219	346	565	0.9	559	1 506	2 065	1.8
<b>Total</b>	<b>26 594</b>	<b>23 365</b>	<b>49 959</b>	<b>36 429</b>	<b>56 029</b>	<b>92 458</b>	<b>7 812</b>	<b>6 993</b>	<b>14 805</b>	<b>10 146</b>	<b>12 809</b>	<b>22 955</b>	<b>34 406</b>	<b>30 358</b>	<b>64 764</b>	<b>100.0</b>	<b>46 575</b>	<b>68 838</b>	<b>115 413</b>	<b>100.0</b>

**Table 5: International and foreign security issues classified according to borrower, million ECUs**

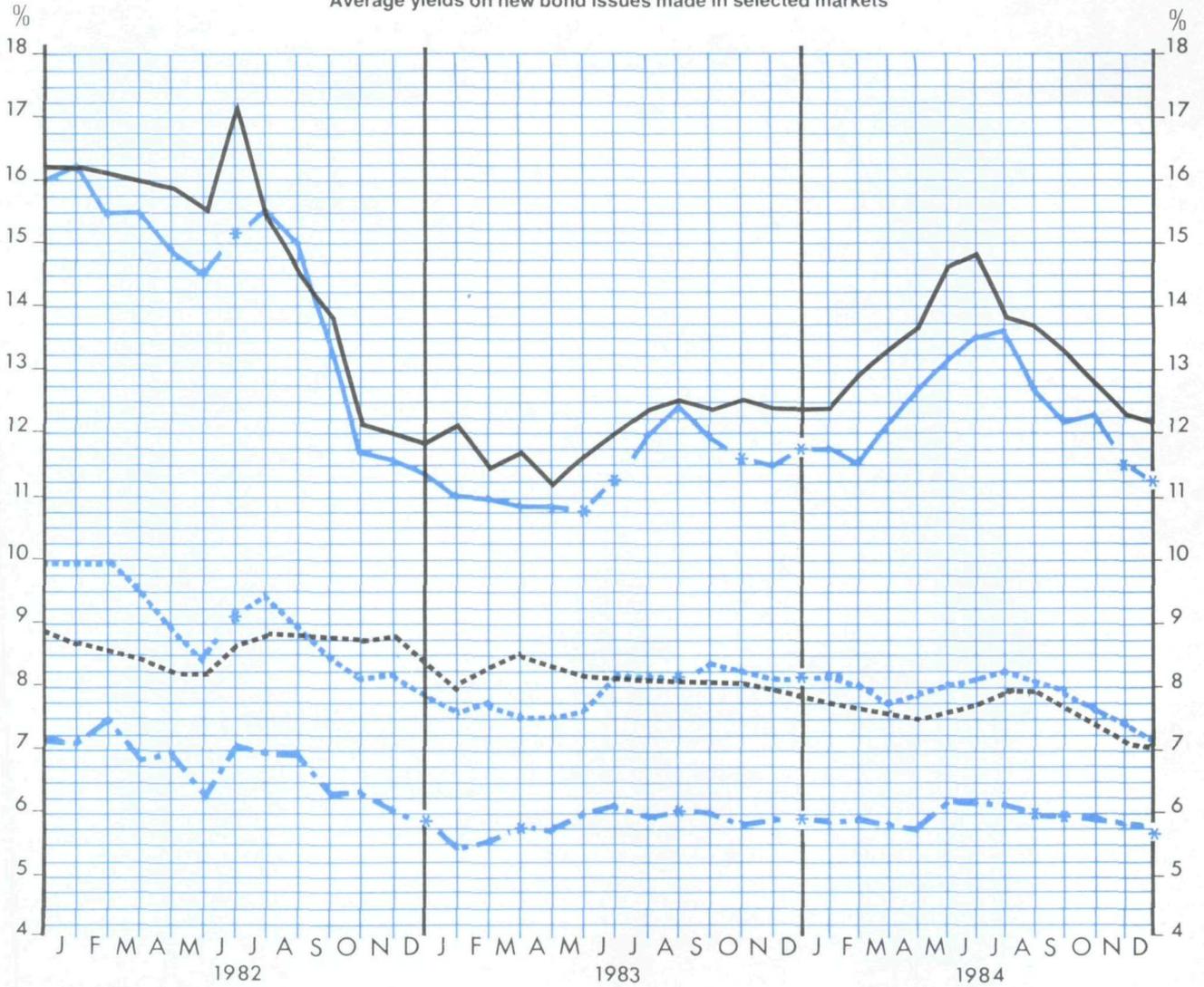
Borrowers	International issues						Foreign securities						Total							
	1983			1984			1983			1984			1983				1984			
	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	1st H.	2nd H.	Total	%	1st H.	2nd H.	Total	%
I. Developed countries	25 055	20 283	45 338	33 718	51 621	85 339	4 986	4 800	9 786	7 963	7 201	15 164	30 041	25 083	55 124	85.1	41 681	58 822	100 503	87.1
<i>Borrowers in EEC countries (incl. EEC organisations)</i>	10 604	9 742	20 346	12 102	15 507	27 609	1 680	1 634	3 314	1 729	2 530	4 259	12 284	11 376	23 660	36.5	13 831	18 037	31 868	27.6
<i>Other developed countries</i>	14 451	10 541	24 992	21 616	36 114	57 730	3 306	3 166	6 472	6 234	4 671	10 905	17 757	13 707	31 464	48.6	27 850	40 785	68 635	59.5
II. Developing countries	277	1 269	1 546	1 127	1 684	2 811	232	162	394	179	407	586	509	1 431	1 940	3.0	1 306	2 091	3 397	2.9
<i>OPEC countries</i>	8	292	300	—	333	333	32	46	78	—	—	—	40	338	378	0.6	—	333	333	0.3
<i>Other developing countries</i>	269	977	1 246	1 127	1 351	2 478	200	116	316	179	407	586	469	1 093	1 562	2.4	1 306	1 758	3 064	2.6
III. Eastern European countries (incl. Comecon organisations)	—	—	—	—	87	87	—	—	—	—	—	—	—	—	—	—	—	87	87	0.1
IV. Other internat. organisations <sup>(1)</sup>	1 262	1 813	3 075	1 584	2 637	4 221	2 594	2 031	4 625	2 004	5 201	7 205	3 856	3 844	7 700	11.9	3 588	7 838	11 426	9.9
<b>Total</b>	<b>26 594</b>	<b>23 365</b>	<b>49 959</b>	<b>36 429</b>	<b>56 029</b>	<b>92 458</b>	<b>7 812</b>	<b>6 993</b>	<b>14 805</b>	<b>10 146</b>	<b>12 809</b>	<b>22 955</b>	<b>34 406</b>	<b>30 358</b>	<b>64 764</b>	<b>100.0</b>	<b>46 575</b>	<b>68 838</b>	<b>115 413</b>	<b>100.0</b>

<sup>(1)</sup> African Development Bank, Asian Development Bank, Council of Europe, Eurofima, Inter-American Development Bank, Nordic Investment Bank, World Bank.

Source: EIB.

\* Excluding issues by Canadian borrowers.

Average yields on new bond issues made in selected markets



- International U.S. \$ bond market
- ⋯ International DM bond market
- - - Swiss market in foreign issues
- ⋯ Japanese market in foreign issues
- U.S. domestic market (medium-term issues by Aa rated public utilities)

bonds with maturities between 7 and 15 years issued by first class borrowers  
 Source: EIB  
 Source: Salomon Brothers

Yields are calculated according to the standard method used by the International Association of Bond Dealers - I.A.B.D.  
 The sign \* indicates the absence of new issues by first class borrowers.

the forefront of financial developments last year, especially on the international capital market. With an estimated amount of swapped principal probably not far off a US\$ 70-80 billion annual range, and an increasingly liquid secondary market, the swap concept has been gradually extended to accommodate a widening spectrum of financial requirements and to cater for the funding and hedging needs of a more and more diversified clientele. Swapping techniques were evolved in order to profit from changing market opportunities, as the concept itself became more thoroughly understood and the full range of possibilities was more properly appreciated. This tended to increase the integration of capital markets and the arbitrage between market imperfections. Swaps also tended to enhance the possibilities of access to a larger number of financial centres both for borrowers and investors.

By the same token, however, certain dangers have become apparent to a number of monetary authorities who fear being confronted with a widening of the international use of their currencies beyond their control caused by a growing penetration of their domestic capital markets by often unidentifiable borrowers via swap operations. Limiting the latter to already outstanding liabilities, while denying authorisation to the initiation of swap-oriented fund raising transactions by non-resident borrowers, appears on the other hand to have been an effective countermeasure. Against this the dangerously low or even negative margins accepted by some domestic banks on currency swap business in Japan and in the euroyen market in taking advantage of the movement towards financial deregulation has provoked criticism by the monetary authorities in that country.

#### Developments in floating rate note issues

Also spearheading the innovative efforts of the international financial community were new developments in issues of floating rate notes, partly in response to competition from the growingly popular note issuance facilities. Even though an increasingly competitive lending environment and the particular point reached in the recovery phase of the economic cycle also played a role, their outstanding performance in the 1984 financial scene is mainly attributable to three independent circumstances. These were in the first place the need to allow borrow-

ers to profit from generally falling interest rates, secondly, the opportunity offered by issues of very long dated or perpetual floating rate notes to correct unduly high gearing ratios and, thirdly, the opportunity of improving the liquidity of loan portfolios (burdened, in the case of a substantial number of the most active international banks, with illiquid long-term loans) and to increase the amount of fee-earning activities and bolster sagging asset returns.

For the more creditworthy borrowers, both sovereign and corporate, the search for improved borrowing terms led quickly beyond the paring of interest rate margins on their securities to produce a radical overhaul of pricing techniques. Both the US prime and the London inter-bank offered rates saw their pre-eminence as universal benchmarks of eurodollar transactions rapidly eroded in favour of usually lower reference rates, such as the bid or the average of bid and offered interbank rates or, in a more dramatic departure from traditional euromarket practices, the growing use of the US domestic short-term rates, such as the commercial paper and Treasury bill rates. These new pricing techniques were most conspicuously used by Sweden in its repeated forays into the international capital markets last year, but also by other sovereign borrowers such as Denmark, Italy and Spain, and, among supranational bodies, by the World Bank. A large number of well-known international banks and prime corporate names also issued floating rate notes or arranged note issuance facilities priced at rates lower than Libor.

Financial intermediaries not enjoying a broad funding base in the US domestic market found it increasingly hard to compete. Even though the swap of fixed rate eurodollars for floating rate domestic dollar-de-

nominated liabilities was an occasional answer to the new funding requirements, alongside the sometimes more promising route of a broader use of non-dollar currencies in international finance (the ECU in particular), a number of financial intermediaries were obliged to expand their lending to lower rated borrowers in so far as they wished to remain in this sector of business.

The squeezing of interest rate margins had adverse implications for the loan portfolios of many banks which had participated in syndicated credits because of the intention, often declared, of certain of the largest and most creditworthy borrowers to use the proceeds of their newly acquired, cheaper funds to prepay previously arranged costlier credit lines. This latter development, particularly pronounced in the case of a number of European sovereign and corporate entities, was prompted by the substantial turnaround in European current account balances (mirrored in the parallel worsening of the US external accounts) and by the improving economic conditions which tended to generate healthier corporate cash-flows. Thus, even though the funding programmes of certain borrowers may have seemed likely to be overstretched, the net increase in their outstanding foreign debt was small in the majority of cases, and the aim of reducing its average cost and of lengthening and smoothing its maturity profile appeared on the whole to be successfully achieved.

In an attempt to strengthen their financial structures without having to tap sometimes unreceptive stock markets, a number of prime international banks resorted to an old device in launching their floating rate notes by issuing variable rate securities bearing several equity-type features. The most common features

**Table 6: Resources raised by official international institutions for financing development**

	million ECUs			
	1983		1984	
	Public bond issues	Others	Public bond issues	Others
World Bank	4 345	5 683	6 107*	7 782*
Inter-American Development Bank	1 180	366	1 814	369
Asian Development Bank	811	202	1 203	0
African Development Bank	25	135	433	n.a.
European Investment Bank	2 315	1 304	3 417	944

\* preliminary

which duly attracted attention were very long terms to maturity (or, in a number of instances, even the absence of a maturity date) and their nature of subordinated debt instruments. Though the stated objective was, as just mentioned, to increase the proportion of funds which rank as primary capital, some supervisory authorities made it clear that they were unprepared to accept such funds as fully equivalent to equity for regulatory purposes, unless specific and very strict criteria were met. Despite this reaction on the part of certain authorities, however, interest in issuing long-term bank floating rate notes remained strong and as the year drew to a close more of these instruments came to the market.

#### **Other technical variations**

Finally, low coupon bonds and fixed rate securities offering variously designed interest rate revision and prepayment clauses made brief reappearances in 1984 as short-term windows of investors' interest opened, but on the whole their quantitative significance has been far more modest than in earlier years.

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#### **The currencies in which bonds were issued**

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Because of the sharp appreciation of the dollar, it is particularly difficult to compare the performance of dollar markets in 1984 with that of other currency sectors but unmistakably, the US dollar retained its dominant position in international new issues. The amount raised in US dollars, which reached 79.7 bn ECUs and rose to 69% of total public issues from 63.4% in 1983. Most of this growth occurred in international issues in spite of a narrowing in the yield differential between them and issues on the New York (Yankee bond) market, helped largely by the repeal in July of the withholding tax on foreign holders of bonds issued in the U.S.A.

The strength of the US dollar against most other major currencies has attracted international investors, taking into account the high real rates of interest available, but at times it has also been a deterrent. An important factor in the growth of the dollar eurobond market, however, has been that by far the greater part of floating rate issues which expanded so rapidly in 1984 are conducted in this currency.

Other capital markets were all affected by the strength of the dollar and the comparatively high interest rates on dollar securities. Particularly affected were Deutsche Mark international and foreign bond issues which declined from 9.9% of the total of such issues in 1983 to 6.2% last year even though the amount raised exceeded that of 1983 by 12%.

Similarly, public issues denominated in Guilders increased in amount by 19% in 1984 but their contribution to total public issues for the year declined to 1.2% from 1.7% the previous year.

However, in contrast, the relative importance of the pound sterling as currency used in international and foreign (Bulldog) issues rose to 6.1% in 1984 from 4.7% the previous year, moving into third place and almost on a par with the Deutsche Mark. This continues the progressive expansion in the use of the pound sterling in international financial transactions since exchange controls were withdrawn in 1979, an important development in 1984 being a threefold increase in floating rate issues. It is also possible that in 1984 the comparatively high yields on sterling issues may have appealed to investors, while the weakness of the pound may have increased its acceptability among a larger number of borrowers.

An increase in the amount of euroyen denominated bond issues in December of last year resulted from an easing of regulations by the Japanese authorities. The amount of euroyen issues for 1984 consequently rose by about 350% compared to the previous year. Nevertheless, the proportion of the total of international and foreign issues accounted for by euroyen and foreign issues on the domestic (Samurai) market of Japan taken together fell slightly to 5.5% as compared with 5.7% in 1983. A more significant drop was observable in the foreign issues denominated in Swiss francs, which when compared with the total market accounted for only 5.1% of the issues, down from 8.6% in 1983.

The popularity of the ECU continued to expand as the spectrum of investors willing to hold ECU securities widened impressively. The sector suffered at times from indigestion but nevertheless the amount of new issues increased by 76% to reach 3.4 bn ECUs in 1984, accounting for 2.9% of the total market. Among these was the first foreign ECU issue in New York, launched by the EEC.

The popularity of the ECU has without doubt been a major factor in the disappearance of issues denominated in SDR and the European unit of account.

Among issues denominated in non-community currencies, those in Canadian dollars were in relatively strong demand and the differential between yields on Canadian dollar securities issued on the international market and those on the US dollar securities narrowed substantially, especially after the second quarter of 1984.

The relative strength of the Norwegian Krone, permitted the admission of more borrowers to the sector, while other smaller amounts were raised in Australian and New Zealand dollars. The amount of French francs borrowed in the form of foreign issues declined slightly in 1984.

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#### **The borrowers**

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US enterprises were the biggest single category contributing to the sharp increase in the amount raised through public bond issues in 1984, borrowing 20 bn ECUs as compared with 5 bn in 1983. Since last July, when the repeal of the US withholding tax legislation took effect, the eurobond market has attracted about 20 US corporations as new borrowers. And for the first time, the US Treasury and two US Federal agencies issued a total of 2.2 bn ECUs of bonds targeted at non-US investors. While foreign investors may now buy registered domestic corporate bonds free of withholding taxes, eurobonds issued by American concerns still attract a premium because they are issued in a bearer form evidently preferred by international investors. Japanese corporations also more than doubled their borrowing on external markets in 1984, raising more than 11 bn ECUs and continuing the upward trend of the past few years.

As may be seen in Table 5, developed countries accounted for more than 87% of international and foreign bond market issues in spite of a decline in the share of borrowers from the European Community to 27.6% from 36.5% in 1983 when the EEC borrowed 4 bn ECUs on behalf of France.

The petroleum exporting countries continued to borrow less in reflection of the decline in the oil industry, but an increase in the other developing countries' borrowing was mostly attributable to South Korea's frequent resort to the international

markets. Hungary and the Soviet Union were the two Eastern European countries to reappear on the international markets after an absence of three years.

To the direct borrowing by developing countries should perhaps be added that of international development banks such as the World Bank, Inter-American Development Bank, Asian Development Bank and African Development Bank. These banks raised about nine-tenths of the 11.4 bn ECUs included under "Other international organisations". Table 6 indicates that the amounts obtained through private placements by the same institutions also rose considerably in 1984 and almost matched the amounts raised through public issues.

On the other hand, only about a tenth of the amounts borrowed by the EIB appearing at the bottom of the table by way of illustration would be destined for projects outside the European Community. Taking this into account, however, it would seem that in total between 18 and 19 billion ECUs would have been raised in 1984 through these international agencies for the ultimate benefit of developing countries.

#### International issues by sector

Table 7 shows that issues by financial institutions continued to dominate in the pattern of international borrowing, amounting to 42.6% of the total market as compared with 40.4% in 1983. The increase reflected the wider use of floating rate borrowing by financial institutions to obtain long-term funds and the expansion of swap related borrowing activities.

Heavier borrowing by American corporations and the general improvement in the investment climate worldwide led to an increase in the funds raised by the manufacturing sector and by the mining sector. In contrast, the share of public utilities in international borrowing became smaller as declining energy consumption made cut-backs in large scale energy investment projects possible.

The sharp decline in the share of the total market obtained by international organisations took place from an exceptionally high 1983 figure which contained the large 4 bn ECUs borrowing by the EEC on behalf of France. On the other hand, the percentage of Government and subsidiary authorities increased partly because of efforts by these borrowers

Table 7: International issues by sector

	Percentage of total			
	1981	1982	1983	1984
Mining, exploitation of hydrocarbon deposits	7.9	7.2	2.2	5.8
Manufacturing	20.2	24.9	12.4	14.8
Commerce	1.6	2.0	1.6	1.5
Transport and communication	5.4	5.8	3.0	3.3
Public utilities (electricity, gas, water)	10.5	8.8	5.8	3.5
Financial institutions	37.0	26.8	40.4	42.6
International organisations	9.0	7.6	15.7	6.4
National governments, provincial and local authorities	7.8	16.2	18.1	20.2
Miscellaneous	0.6	0.7	0.8	1.9
	100.0	100.0	100.0	100.0

Table 8: International and foreign bank loans, classified according to borrowers

	million ECUs					
	1982	%	1983	%	1984	%
Developed countries	55 903	56.5	35 031	47.5	42 167	54.6
<i>Borrowers in EEC countries (incl. EEC organisations)</i>	20 165	20.4	12 335	16.7	17 805	23.0
<i>Other developed countries</i>	35 738	36.1	22 696	30.8	24 362	31.6
Developing countries	41 085	41.6	35 617	48.2	28 844	37.3
<i>OPEC countries</i>	7 792	7.9	7 151	9.7	3 705	4.8
<i>Other developing countries</i>	33 293	33.7	28 466	38.5	25 139	32.5
Eastern European countries (incl. COMECON countries)	567	0.6	1 097	1.5	3 747	4.8
Other international organisations	1 138	1.1	1 233	1.7	2 115	2.8
Unallocated	209	0.2	786	1.1	401	0.5
<b>Total</b>	<b>98 902</b>	<b>100.0</b>	<b>73 784</b>	<b>100.0</b>	<b>77 274</b>	<b>100.0</b>

Table 9: Other international facilities<sup>(1)</sup>, classified according to borrowers

	million ECUs					
	1982	%	1983	%	1984	%
Developed countries	3 353	61.8	13 821	93.2	60 075	88.1
<i>Borrowers in EEC countries (incl. EEC organisations)</i>	1 331	24.5	3 820	25.8	5 659	8.3
<i>Other developed countries</i>	2 022	37.3	10 001	67.4	54 416 <sup>(2)</sup>	79.8
Developing countries	1 780	32.8	821	5.5	7 718	11.3
<i>OPEC countries</i>	456	8.4	165	1.1	659	1.0
<i>Other developing countries</i>	1 324	24.4	656	4.4	7 059	10.3
Eastern European countries (incl. COMECON organisations)	142	2.6	78	0.5	365	0.5
Other international organisations	151	2.8	—	—	—	—
Unallocated	—	—	110	0.8	59	0.1
<b>Total</b>	<b>5 426</b>	<b>100.0</b>	<b>14 830</b>	<b>100.0</b>	<b>68 217</b>	<b>100.0</b>

<sup>(1)</sup> International credit facilities extended by banks to back-up the issue of other financial instruments such as commercial paper, short-term euro notes, certificates of deposits, bankers acceptance and merger-related operations.

<sup>(2)</sup> Including merger-related stand-by credits of US\$ 26.5 bn.

to refinance older debt bearing high coupons at lower cost and partly because of the US Treasury and US agencies venturing into the international market for the first time to borrow the equivalent of 2.2 bn ECUs.

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#### **Internationally syndicated and foreign bank loans and other facilities**

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Traditional medium- and long-term credits arranged by banking syndicates (see Table 8) increased by much less than activity on international and foreign bond markets. Even this increase is more than explained by the appreciation of the US dollar — which is the main currency — in terms of the ECU. If a correction is made for this appreciation, new business contracted by 7%.

The continuing debt problems of a number of Third World countries and the better foreign exchange position of others kept them away from credit markets and contributed to the decline in lending activity of international banking syndicates.

Loans signed by OPEC were more than halved as borrowing by Algeria almost disappeared and other members, with the exception of Qatar and Saudi Arabia, also reduced their borrowing. East European countries obtained credits for an amount more than three times that raised in the previous year. Main borrowers were the Soviet Union, East Germany and Hungary.

Borrowing through syndicated bank credits by countries around the Mediterranean Basin in which the EIB may lend declined by almost 25%. To the sharp reduction in Algerian operations was added a considerable drop in new borrowings by Yugoslavia as well as more modest declines for several other borrowers. Increased lending to Spain and Turkey only partly offset the general decline. Lending to the signatories of the Lomé Convention was almost halved: while Papua New Guinea and Mauritius increased their borrowing. Borrowing elsewhere, particularly in Nigeria, Cameroon and Trinidad and Tobago, fell.

Although the U.S. dollar remained by far the most important currency of denomination, the progressive erosion of its role continued. Reflecting the increasing internationalisation of the Japanese Yen and importance of Japanese banks in international finance, the proportion

of credits granted in Yen grew larger. A further notable development was the rising amount of new credits denominated in ECU which have placed it fourth after the US dollar, the Yen and the pound sterling in this sector of the market. Among other currencies used in the granting of credits were principally the Swiss franc, the Deutsche Mark and the Australian, Canadian and Hong Kong dollars.

Against a background of a net reduction in demand for credit and intensified competition between banking syndicates, spreads above reference rates tended to narrow, maturities to lengthen and commissions to diminish. A number of borrowers were able to negotiate re-scheduling packages in which the terms of the new credits were lower than on the original credits. A further feature is that credits have increasingly been priced off LIBOR rather than the generally higher U.S. prime rate.

In contrast to the reduction in borrowing by the Third World, the take up of credits by developed countries was larger in 1984 than in the previous year but might have been larger still, were it not for the sharp increase in other medium-term facilities favoured by first class corporate and sovereign borrowers because of their lower cost. These facilities mainly consist of medium- and long-term lines of credit to back the continuous issue of short-term notes. The issues of notes have themselves met with good demand from banks and institutional investors, particularly when launched by prime sovereign and corporate borrowers. A few of such borrowers have proceeded to arrange multi-purpose cover which would enable them to activate a range of borrowing instruments according to choice. Contrasting with the rapid development of such financing techniques in industrialised countries, the number of borrowers in developing countries granted back-up facilities has been small and restricted to those in relatively advanced environments such as of South Korea and Hong Kong.

If all forms of international borrowing are taken together, 1984 seen in retrospect was undoubtedly a year of rapid expansion in spite of more than usual uncertainty over the direction of interest rate movements and over the exchange rate for the dollar against all other major currencies. This expansion was made possible by a number of different elements, among which the main

were the adaptability of various sectors of the international market and those of national markets handling external lending in developing their methods of financing, the extent of the deregulation introduced by a number of monetary authorities and, on the demand side, the need for finance in an economic climate that seems to have been more buoyant not only in the U.S.A. but also in other industrialised countries than was first thought to be likely.

It is a little early to assess how far the changes in international borrowing which characterised 1984 are likely to progress or even persist. However, the growth in borrowing through security issues at variable rates of interest, as a means of compensating for interest rate uncertainty, extended over so many techniques and markets in 1984 that this type of borrowing could constitute a much larger part of the market than in the past, possibly making further inroads into the present role of internationally syndicated credits.

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