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DGII-D-2-ECU

25th OF JANUARY 1993

ECU - MARKETS REVIEW

**Part 1 : The ecu markets : major developments throughout
1992 and prospects for early 1993**

Part 2 : Statistical review and assessment

I. 1992 FACTS :

The financial summer crisis, followed by the exchange rate crisis since September, has strongly perturbed the ecu markets throughout the whole of the second semester of 1992. Yet, the market survived quite well :

* On the primary bond market, issuing activity fell sharply from ecu 24.6 bn in the first half to ecu 2.2 bn in the second half of the year, with no international issue from mid-August. The market was re-opened mid-December by the Commission with an ecu 80 mn issue.

* On the secondary bond market activity never stopped. Yet, throughout most of the period, the market faced liquidity problems. After a net improvement end September-October, the liquidity problem resulted from the lack of activity on the primary ecu bond market and of the redeeming of many bonds.

* Derivatives markets, LIFFE and MATIF, have fully played their role : they reached peak levels of activity during the crisis period. The LIFFE short term contract in ecu maintained a high turnover throughout the fourth quarter, while the activity on the MATIF long term contract, although staying at a rather high level, slowed down.

* On the Treasury bills market, the Bank of England profiled as the regular monthly issuer throughout the whole period of crisis. The Bank of Italy only appeared once but for a large amount : ecu 1.3 bn bid and allotted, for ecu 1.5 bn offered.

* The ecu clearing system continued to work very well, with a daily volume up to ecu 60 bn in September, and an average over ecu 40 bn daily transactions during the fourth quarter.

* As a consequence of the September exchange rate crisis, the spread between the theoretical and market values of the ecu exchange rate increased to 200 b.p. Since the beginning of October, however, it returned gradually to the normal level of 10 b.p., a level maintained since.

II. JANUARY 1993 SITUATION AND PROSPECTS :

The good resistance to the crisis of ecu markets and their structures, better prospects for the realisation of EMU after the Edinburgh Summit and the relative easing of the EMS crisis, gave rise to rather positive expectations for the first quarter of 1993 :

* On the primary bond market, activity resumed : the French Treasury issued ecu 680 mn of its 2003 OAT. The success of the issue, with a bid of ecu 2.04 bn, is a good signal for potential official and private issuers. The 3-year UK T-note program will resume on the 2nd of February. EIB is awaited.

* On the secondary bond market, activity has rebounded since the beginning of the year and will be stimulated by the primary activity.

* Other positive developments are :

- the agreement concluded between the German (Frankfurt DTB) and French (MATIF) futures exchanges to allow for reciprocal access to each other's products, including the successful MATIF long term contract in ecu.
- the agreement to create an ecu linked clearing system between Eastern-European banks.
- the agreement between major petrol distributors and producers to introduce a common payments and compensation system in ecu (TEPAR).

PART 1 : THE ECU MARKETS : MAJOR DEVELOPMENTS THROUGHOUT 1992 AND PROSPECTS FOR EARLY 1993

A. 1992 PERFORMANCE

B. PROSPECTS FOR 1993

PART I :

**THE ECU MARKETS : MAJOR DEVELOPMENTS THROUGHOUT 1992
AND PROSPECTS FOR EARLY 1993.**

A. 1992 performance

After a successful 1991, in which the ecu became the second most used currency on the eurobond markets, expectations for 1992 were set rather high, even more so because of the signing of the Maastricht Treaty in February 1991.

In this perspective, the performance on the ecu markets has been rather disappointing throughout 1992 : issuing activity on the primary ecu bond market slid back to its 1990-level of about ecu 26 bn. This nevertheless implies that the ecu was the sixth most used currency in the eurobond market in 1992 (compared to a second position in 1991) behind the US \$, the yen, the Deutsche mark, the French franc and the pound Sterling.

Concerning 1992 developments, however, a clear-cut division can be made between the two halves of the year :

- performance in the first half matched the one of the first six months of 1991 and a clear commitment by the Member States for further issuing in ecu (e.g. the French OAT-program) was present.

In the context of the domestic programs, (which are internationally traded), a total amount of ecu 6.8 bn was issued (nearly as much as for the whole of 1991 : ecu 7.2 bn) in the following way : French OAT, ecu 2.15 bn; Italian CTE, ecu 2.25 bn; Greek ecu linked issues, ecu 0.9 bn and the British 3-year T-notes, ecu 1.5 bn.

Next to these domestic issues, an amount of ecu 17.8 bn of international issues were launched on the primary ecu market during the first half of the year.

On the secondary ecu bond market, monthly average turnover volume for the first half of the year increased to ecu 114 bn compared to an average of ecu 75 bn for the whole of 1991 (with an absolute maximum of ecu 132 bn for the month of June).

On the derivative markets, the MATIF long term contract in ecu reached a maximum of 212.396 contracts in June 1992.

- during the second half of the year, the ecu markets were sent into confusion by several factors : the Danish "no" on the 2nd of June and the uncertainties thus created regarding the ratification of the Maastricht Treaty, added up to the unfulfilled expectations about a lowering of German interest rates and the expectations concerning the French referendum (on the 20th of September) exerted a *negative influence on the evolution in the ecu markets*. Furthermore, the ecu suffered from the September-October exchange rate crisis which was extended throughout most of the fourth quarter and involved several and persistent attacks on the component currencies of the ecu such as the Irish punt, the French franc and the Danish crown.

The above factors resulted in a *near-halt of issuing activity* on the primary ecu bond market : the introduction of announced national programs was postponed (e.g. the Belgian OLO-program), the planned auctions of several other national programs were delayed or suspended (e.g. the French OAT's, the Italian CTE's, the UK 3-year T-note tender of October) and private issuers did not return to the market.

The only domestic program that was carried on throughout the whole of the second half of 1992 was the Greek ecu linked program : a total amount of ecu 0.8 bn was issued (compared to ecu 0.9 bn).

On the secondary ecu bond market, the monthly average turnover volume fell back throughout the second semester of the year resulting in a monthly average turnover of ecu 82 bn at the end of 1992, notwithstanding the improvement throughout September-October (because of swap operations and recompositions of portfolio's). One of the factors explaining this drawback is the absence of new high quality paper on the market and the fact that several high quality issues came to maturity in November-December. It must be stressed, however, that the monthly average turnover for 1992 nevertheless remained superior to the monthly average of 1991.

On the ecu Treasury bills market, the UK continued its monthly issuance of T-bills throughout the whole of the second half of 1992 although, since the October auction, a policy of maximum acceptable yields was introduced. This policy severely limited demand for the October issue and impeded a full

allocation of the November and December issues. Issuance under the Italian BTE-program, was suspended between the end of May and mid-October when the Banca d'Italia launched an ecu 1.5 bn BTE which was not fully allotted (ecu 1.3 bn subscribed).

On the derivative markets, the number of contracts traded daily increased considerably during the ERM crisis of September-October 1992 (e.g. the LIFFE short term contract in ecu registred a maximum of 41.000 contracts during September 1992), after which the market dropped sharply (due to the drying out of the underlying cash markets). Overall, however, the volume traded exceeded the 1991 average. The suspension of the LIFFE long term contract in ecu, however, was not due to the ERM crisis but rather to the competition of the more successful MATIF contract).

The September developments were clearly reflected in the evolution of the spread between the theoretical and market value of the ecu exchange rate. The spread which, during the summer bond market crisis, remained unchanged at a level of 10 b.p., widened to reach a peak of 200 b.p. by mid-September (displaying a devaluation of the market ecu towards its basket). By the end of September, the spread had again narrowed to 60 b.p. and, by October come back to a level of 10 b.p.. At present, the spread has reversed, displaying a revaluation of the market ecu towards its basket.

Notwithstanding the rather negative developments during the second half of 1992, there was a clear commitment of several Member States in support of the market : the French Treasury created a reserve fund of ecu 0.7 bn to guarantee the liquidity in the secondary market in ecu denominated OAT's. The Bank of England and the Banque de France announced the creation of a "same-day value" payments system in ecu in 1993. Furthermore, through the SWIFT operated ecu clearing system transactions reached a peak of ecu 55 bn in September and, even at the end of November, the average daily activity remained above ecu 42 bn, thus exceeding the average activity throughout 1991.

Conclusion :

As a conclusion it can be said that, although the crisis was certainly the strongest ever known since the beginning of the market, the ecu markets and their structures have well survived the crisis : at no time the markets were

closed. The primary ecu bond market is the one which suffered most. The secondary ecu bond market, the money market and all the derivative markets continued their activities with a rather high turnover : even if inferior to the high levels reached during the first half of the year, turnover often remained superior to 1991 figures.

B. Prospects for 1993

With the return of greater stability within the ERM and the ratification of the Maastricht Treaty back on track since the Edinburgh Summit of last December, the year 1992 closed and 1993 started for the ecu markets on a positive tone. Although the market is not expected to boom like in the first half of 1992, positive developments are already discernible and issuing activity on primary markets is expected (some issues already have been announced).

On the ecu primary bond market, the EC ecu 80 mn issue (for Hungary) of mid-December, re-opened the market after five months of inactivity. Although the amount remained rather limited, the issue was significant : launched just after the Edinburgh Summit, it has been considered as a signal for the market that the Danish problem was solved and that the Treaty would be ratified. It also showed that a demand exists for high quality paper and that other issues might be equally successful. Similar issues by the EC might follow (ecu 80 mn for Romania and ecu 100 mn for the Baltic States). Next to this first institutional issue, a sovereign issue has already taken place on the 28th of January and another one has been announced :

The French Treasury re-entered the market with a very successful (demand : ecu 2.04 bn) 10-year ecu 680 mn OAT issue on the 28th of January (this after an absence of about six months). It further announced that it will issue 15% of its 1993 debt in ecu (an intention already formulated in 1992 but not fully realised as a consequence of the ERM crisis), this by issuing at least once every quarter.

The Bank of England announced the auction of its January 3-year T-bill tender for an amount of ecu 500 mn, scheduled on the 2nd of February. After the success of the French OAT-issue, the Bank of England is expected to issue T-notes for a higher amount than the initially announced ecu 500 mn.

In addition, the EIB, the largest borrower in ecu, has announced that it plans to further stimulate the markets in ecu instruments.

On the Treasury bill market, the Italian Treasury re-entered the market on the 11th of January with a very successful ecu 750 mn BTE. Also the UK T-bill tender of the 14th of January has been more successful than the three previous ones (October, November and December 1992).

Significant for developments on **the derivative markets of the ecu** is the concluding of an agreement between the French MATIF (Marché à Terme des Instruments Financiers) and the German DTB (Deutsche Terminboerse), allowing for the reciprocal access to some of each others products, including the access to the successful MATIF long term contract in ecu on the Frankfurt exchange.

In the context of the use of the ecu, two other significant developments have to be mentioned :

- At the beginning of December 1992, an association of producers and distributors of gas, TEPAR (Texaco, Elf, Petrogal, Agip, Repsol)-a sector which is said to be completely US dollar integrated-, has announced the creation of a common payment and compensation system in ecu for distribution operations within Europe.

- Furthermore, a group of 10 Eastern-European banks have signed an agreement to create a clearing and payment system linked to the ecu (Association Bancaire de Compensation). This private initiative -strongly helped and supported by the Commission services- represents a potential first post-communist international payments system for the region. The proposed clearing system will use the ecu as a unit of account and will use the already existing ecu clearing banks in Western-Europe as clearing agents. Next to the ten banks responsible for the set-up of the system, other banks and countries are expected to join the system soon.

Conclusion :

Although 1993 starts for the ecu markets in complete contrast to 1992 and although the market will retain some political handicap until the next Danish referendum in the spring, signs indicate that the worst is now over. At present, ecu bonds yield rather favourable returns (market yields developing closer again to DM yields). Not only may financial markets know a strong revival, but also the specific use of the ecu in transactions could be well boosted during the year.

PART 2 : STATISTICAL REVIEW

	Page
I. Bond market : evolution	7
-primary market	
-secondary market	
II. Bond market : structures	8
-by type of issuer	8
-domestic issues	9
(UK, IT, FR, GR)	
III. Banking sector	10
-all sectors	
-non-bank sector	
IV. Short term national programmes (UK and Italian Treasury bills)	11
V. Derivative markets	12
-MATIF	
-LIFFE	
-FINEX	
VI. Euro-notes	13
VII. Basket value versus market value	13
VIII. Exchange markets and interest rates	14

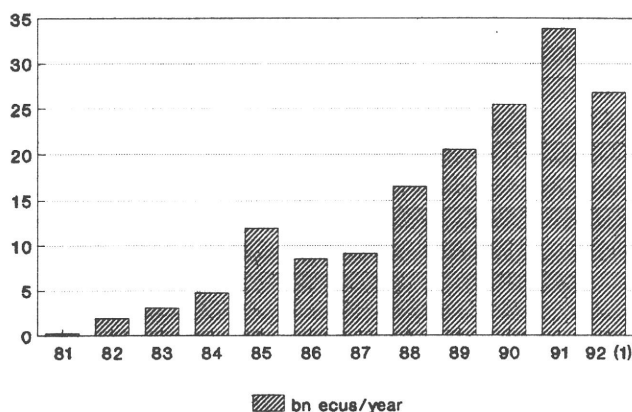
I. BOND MARKET : EVOLUTION

ecu market 1

I.1 Historical evolution

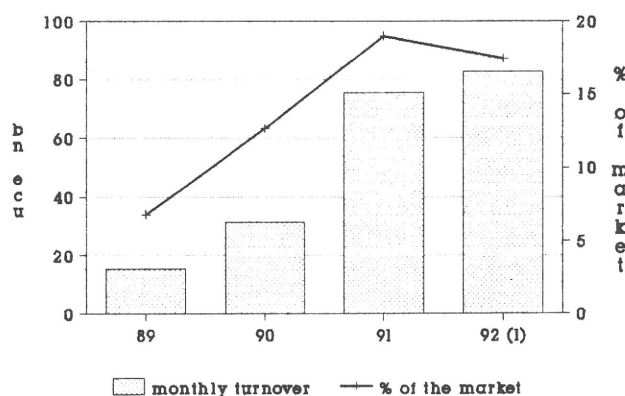
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A. PRIMARY MARKET



(1) end of year figures
SOURCE: EUROSTAT

B. SECONDARY MARKET



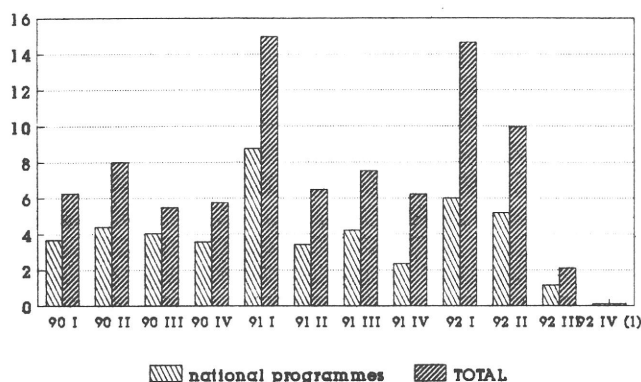
(1) end of year figures
SOURCE: Cedel, Euroclear

- The Danish and French referendum, the financial turbulences and the ERM crisis since September 1992, influenced considerably the performance of the primary ecu bond market during the second half of 1992 : issuing activity came to a near-halt after the summer. The total 1992 amount issued still reached ecu 26 bn, this was mainly due to the high issuing activity throughout the first half of the year.

- The activity on the secondary ecu bond market was equally perturbed : after August 1992, activity slowed down considerably. Nevertheless, 1992 average monthly turnover volume was maintained at ecu 82 bn, still about ecu 7 bn higher than in 1991.

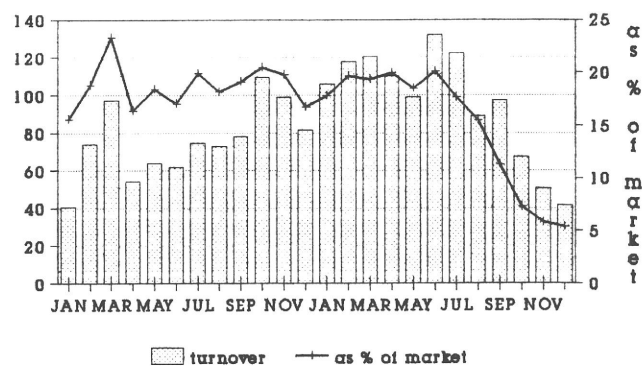
I.2 Recent evolution

A. PRIMARY MARKET (quarterly in bn ecus)



(1) end of year figures
SOURCE: EUROSTAT

B. SECONDARY MARKET (monthly turnover in bn ecus)



(1) end of year figures
SOURCE: Cedel, Euroclear

- On the primary bond market, the fourth quarter ended with the only issue of the quarter : the EC ecu 80 mn issue. Issuing activity by French and British Treasuries has already been announced for the first quarter of 1993.

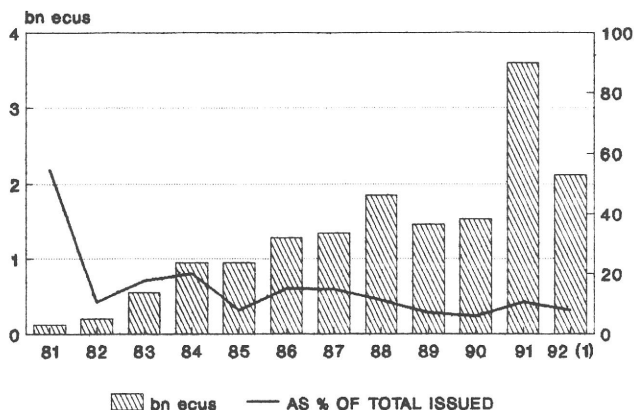
- On the secondary market, the fourth quarter was characterised by low activity (average monthly turnover volume : ecu 53.5 bn compared to ecu 114.5 bn for the first quarter of the year) which was mainly due to the absence of new issuing activity on the primary market and the redeeming of several high quality issues. The market has strongly rebounded since the beginning of 1993.

II. BOND MARKET : STRUCTURES Bonds by type of issuer

ecu market 2

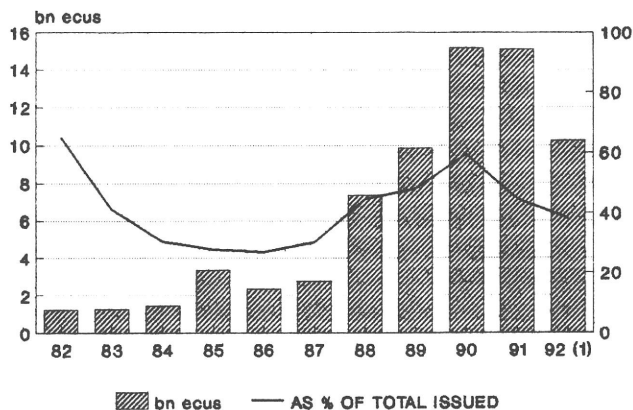
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A. EEC INSTITUTIONS



(1)end of year figures
SOURCE: EUROSTAT

B. MEMBER STATES

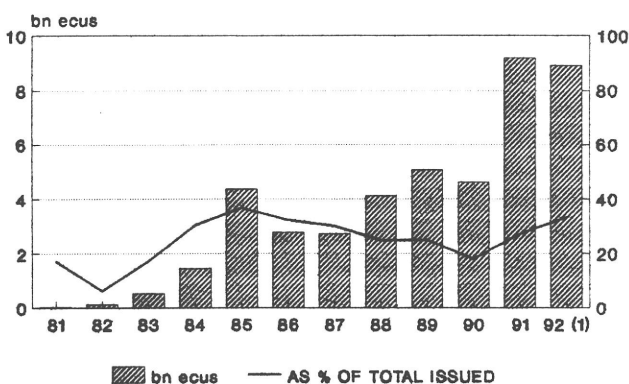


(1)end of year figures
SOURCE: EUROSTAT

- The market share of the EC Institutions has been reduced in 1992 to 7.9% (compared to 10% in 1991). This development is mainly due to the absence of issuing activity throughout the second half of 1992 (with the exception of the EC ecu 80 mn December issue).

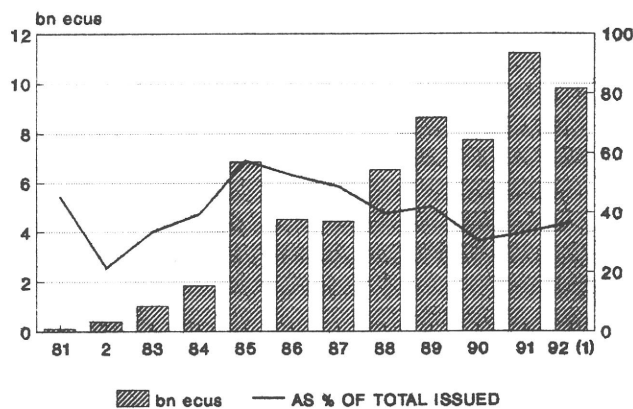
- The market share of the Member States has been in constant decline since the 57.2% peak of 1990 to reach 38.9% in 1992. New issues have been announced for the first quarter of 1993 (the ecu 500-700 mn French OAT and the ecu 500 mn UK 3-year T-note).

C. NON EEC (public and private)



(1)end of year figures
SOURCE: EUROSTAT

D. PRIVATE SECTOR



(1)end of year figures
SOURCE: EUROSTAT

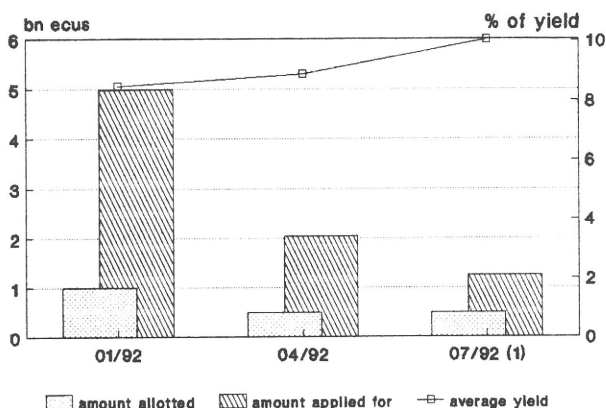
- Although the market share of non-EC operators remains about 5% above its 1991-level, the considerable improvements of the first half of the year (raise in market share of about 10%) have been reduced by the absence of activity throughout the second half.

- Compared to the whole of 1991, the market share of the private sector has increased by about 3.5%.

Domestic issues

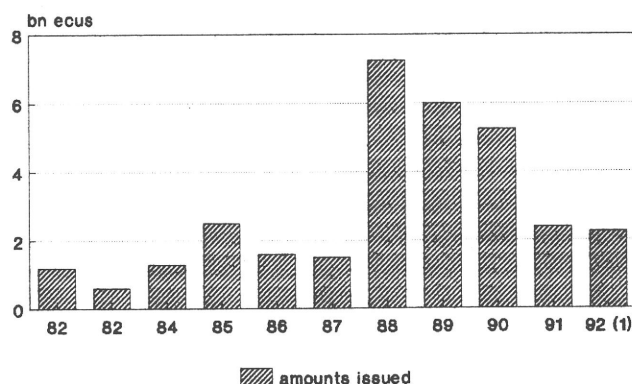
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A. UK T-NOTE PROGRAMME IN ECU



(1)end of year figures
SOURCE: EUROSTAT

B. Italian Treasury certificates in ecu CTE's

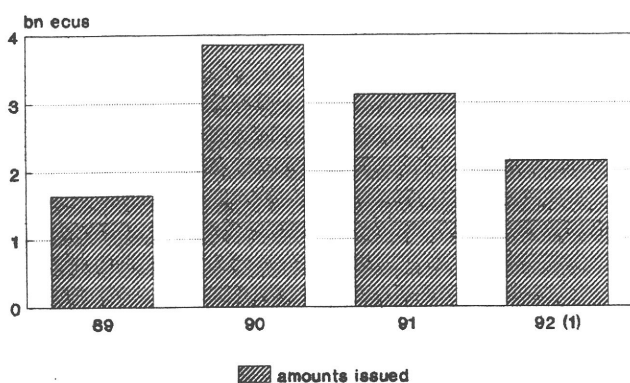


(1)end of year figures
SOURCE: EUROSTAT

- In October 1992, the Bank of England announced that the prevailing market conditions did not allow for the scheduled auction of its 3-year T-note program in ecu. Nevertheless, ecu 2 bn were issued in 1992. End January 1993, the Bank announced it will re-enter the market on the 2nd of February with an ecu 500 mn issue.

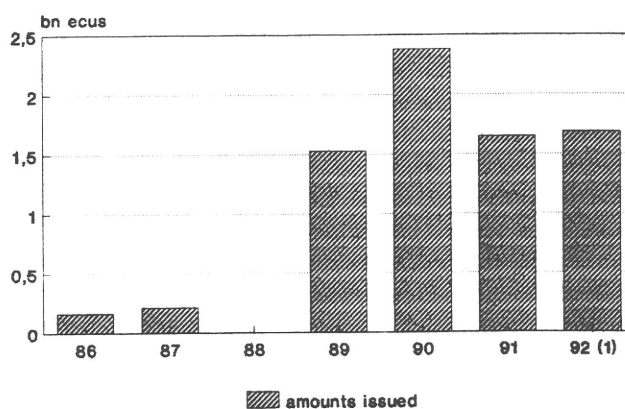
- Since last May no new issues have been made under the Italian CTE (Certificati del Tesoro in ecu) program. A total amount of 2.25 bn was issued in the first five months of 1992.

C. FRENCH FUNGIBLE TREASURY BONDS OAT's



(1)end of year figures
SOURCE: EUROSTAT

D. Greek ecu-linked bonds



(1)end of year figures
SOURCE: EUROSTAT

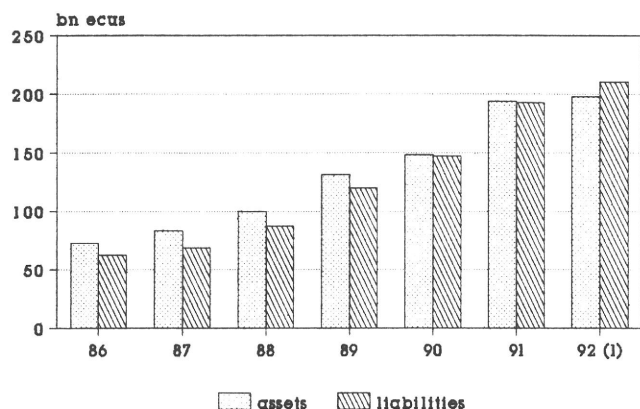
- The French Treasury was the first 1993 to announce an ecu 680 mn OAT, issued on the 28th of January. Ecu 300mn will be issued for repo activities. The Treasury further stressed its intention to issue 15% of its borrowing requirements for 1993 in ecu.

- Issuing activity under the Greek ecu linked program was maintained at a level of ecu 1687 mn, with issues equally spread over the two halves of the year.

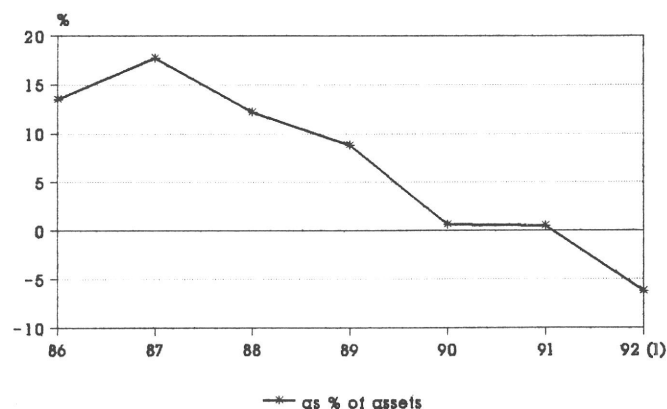
III. BANKING SECTOR

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A. BANKS ASSETS AND LIABILITIES



B. BALANCE OF BANKS POSITIONS



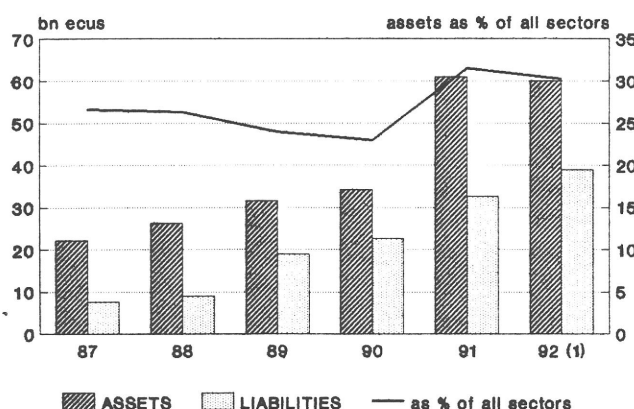
(1) June 1992
SOURCE : BIS

(1) June 1992
SOURCE : BIS

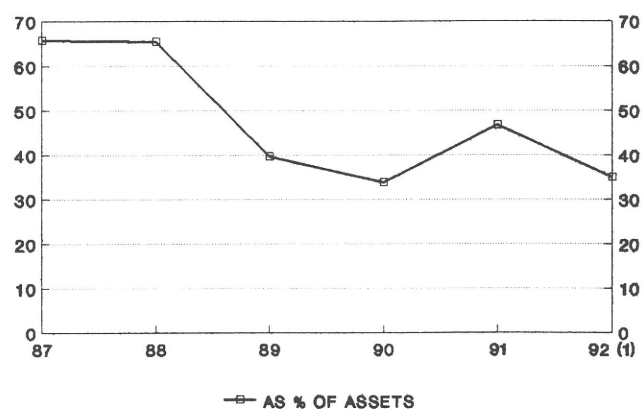
- During the first half of the year, the activity of the ecu banking sector has continued its growth (although at a slower pace than in 1991) : the liabilities reached a level of ecu 210 bn.

- The tendency for liabilities to exceed assets, which was already clearly pronounced in the first quarter of 1992, was continued in the second quarter (liabilities exceeding assets by 6.2% of assets). The near-equilibrium between assets and liabilities was maintained.

C. NON-BANKS ASSETS AND LIABILITIES



D. BALANCE OF NON-BANKS POSITIONS



(1) March 1992
SOURCE : BIS

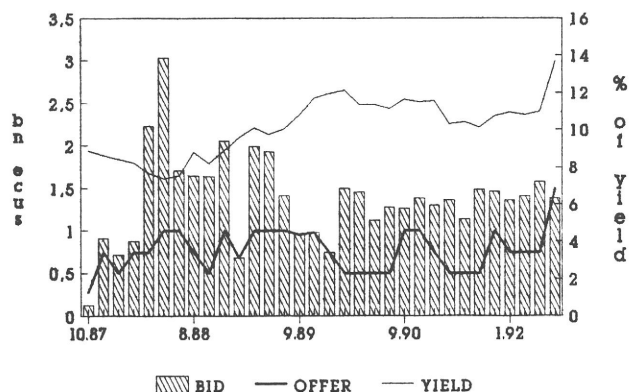
(1) June 1992
SOURCE : BIS

- Although assets still by far exceed liabilities (ecu 21 bn), the gap is narrowing. The imbalance represents 35% of assets, compared to 46.7% for 1991. The narrowing of the gap can mainly be ascribed to an comparatively strong increase in liabilities during the first half of 1992.

IV SHORT TERM NATIONAL PROGRAMMES

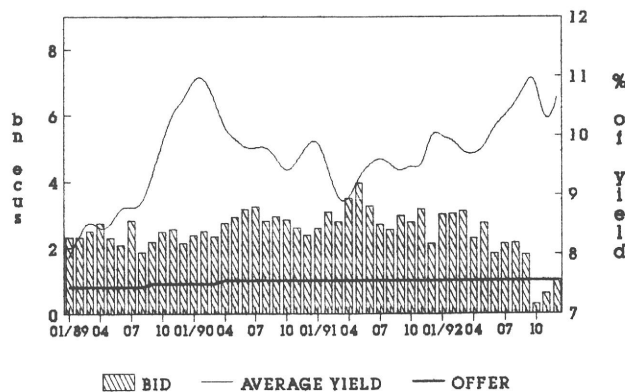
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A. ITALIAN TREASURY BILLS



(1) end of year figures
SOURCE: EUROSTAT

B. BRITISH TREASURY BILLS

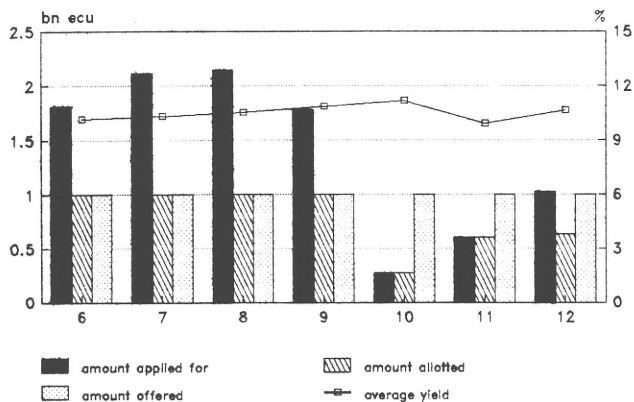


(1) end of the year figures
SOURCE: EUROSTAT, BANK OF ENGLAND

- In the first half of the year, the Italian Treasury bill market in ecu has known the stable pattern of the previous year, with an amount of ecu 2.25 bn issued. For three issues, demand more than doubled the offer. This was no longer the case for the October issue of ecu 1.5 bn : demand did not exceed ecu 1.3 bn.

- Although the UK T-bills have been offered on a regular basis, there is a clear division to be made between the three first quarters of the year and the last quarter. In the first period, demand was considerably superior to the offer (2 to 3 times as much). In the second period, this was no longer the case.

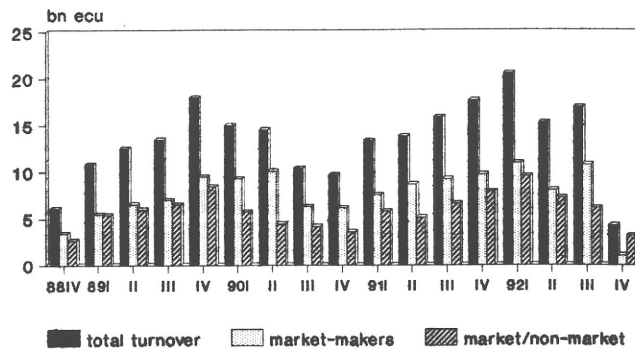
C. UK Treasury Bills in ecu



June-December 1992

C. British Treasury bills in ecu

Secondary market : turnover volumes in bn ecu



SOURCE: Bank of England, Services de la Commission

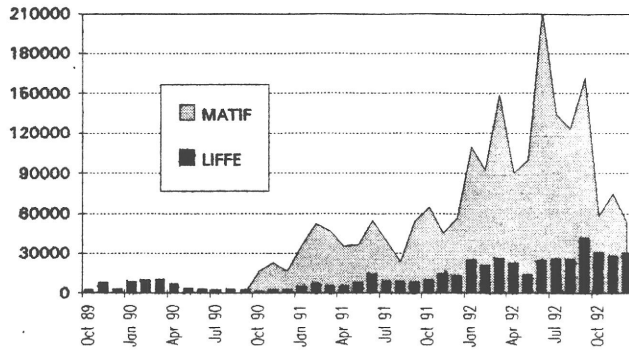
- Although, after October, market conditions improved, the Bank of England maintained its maximum acceptable yield policy. This resulted in December in a situation where the tender was oversubscribed yet not fully allotted to tenderers.

- The secondary market for UK T-bills also suffered from the crisis on the primary market : total turnover fell back to one third of the activity registered for the previous quarters. This was mainly due to the sharp decrease in activity among market-makers.

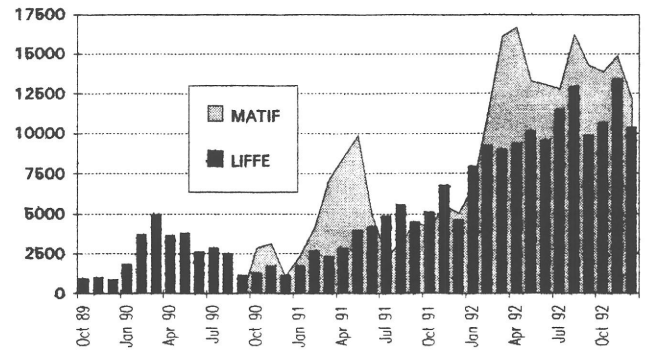
V. DERIVATIVE MARKETS

A. Futures contracts : LIFFE - MATIF (Oct. 1989 - Dec. 1992)

DAILY TURNOVER



OPEN CONTRACTS

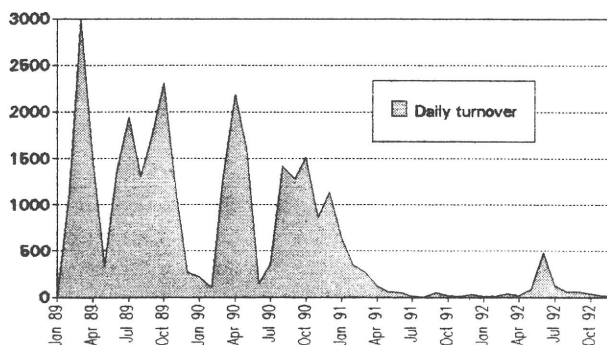


- **MATIF** : the number of ecu long term contracts registered reached an all time high peak in June 1992 (212.396). Until the beginning of October, the number of contracts registered remained above 120.000 contracts. The number of contracts registered throughout the last quarter of the year fell back to a level between 50.000 and 75.000 contracts following a lack of activity in the underlying cash market.

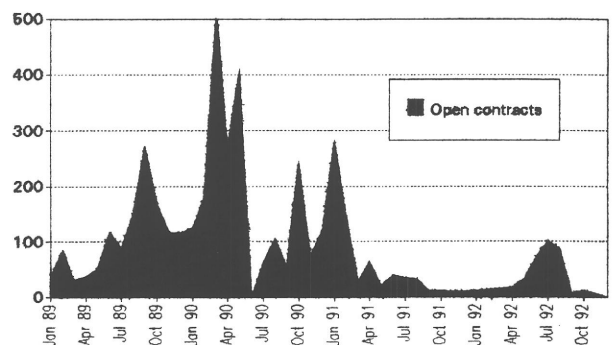
- **LIFFE** : after the peak reached in September (41.820), the number of short term contracts registered decreased somewhat although remaining above 28.000 (largely above the average for 1992).

B. Ecu / dollar options contract : FINEX (Jan. 1989 - Dec. 1992)

DAILY TURNOVER



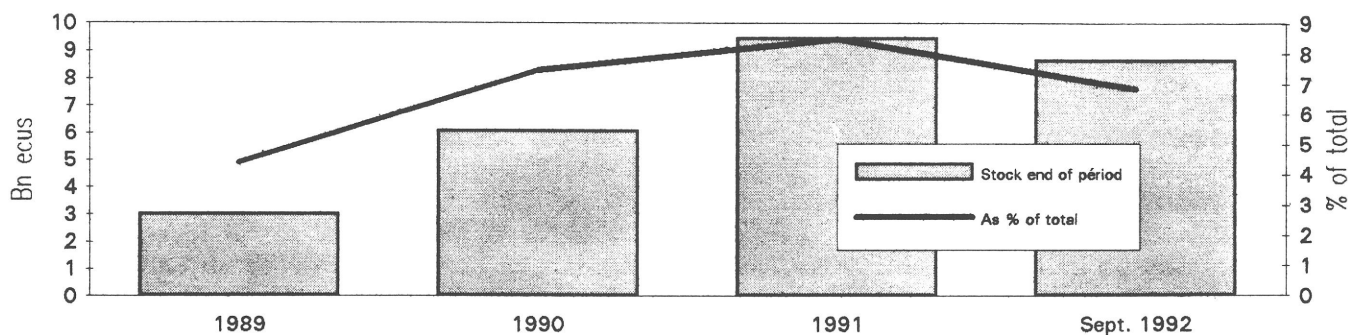
OPEN CONTRACTS



- **FINEX** : after the peak in the number of contracts registered for May on the FINEX ecu/dollar futures market, a high level of activity was maintained throughout the third quarter of the year after which activity again decreased to the level registered at the beginning of the year.

VI. EURO NOTES

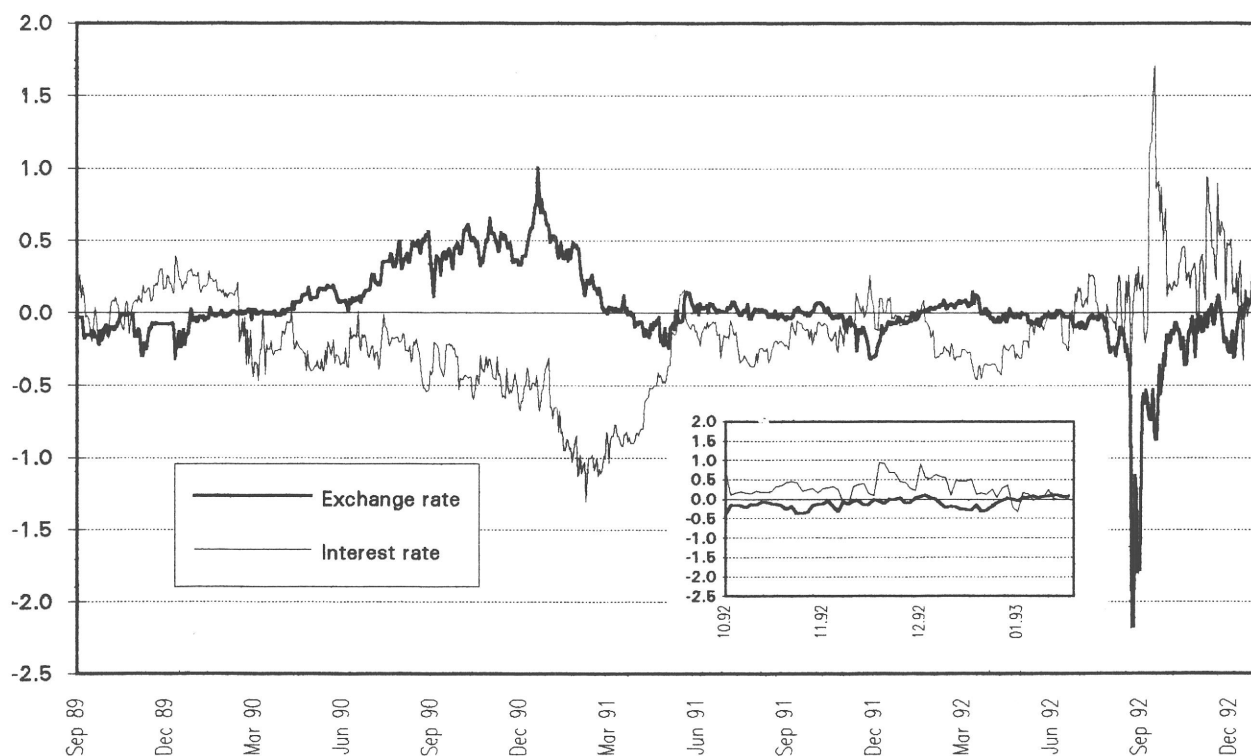
Ecu Market 7
25.01.93



- The slowdown in the rate of growth characterising the ecu euro-notes market throughout the first half of 1992, was continued throughout the third quarter. The decrease characterising the third quarter can mainly be ascribed to the contraction in the outstanding volume of short term paper denominated in ecu.

VII. BASKET VALUE / MARKET VALUE

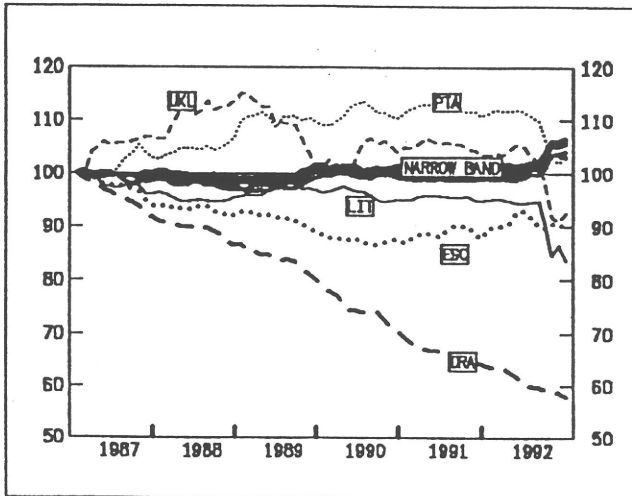
SPREAD BASKET / MARKET VALUE ECU
(25 Sept. 1989 - 22 Jan. 1993)



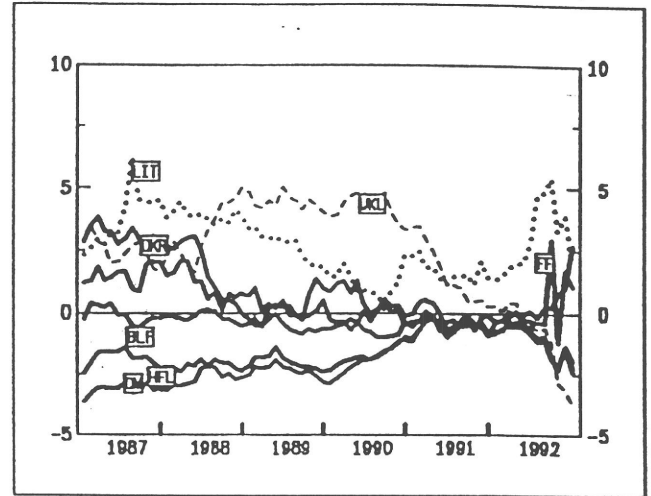
- With the return to gradually more normal conditions since the ERM crisis of last September, the spread between the theoretical and market value of the ecu exchange rate has narrowed to reach again, by the end of 1992, a spread below 10 b.p. Fluctuations in the spread between the theoretical and market value of the ecu interest rates have been quite important over the last 4 months partly due to frequent movements in the interest rates of the component currencies of the ecu.

VIII. EXCHANGE MARKETS AND INTEREST RATES

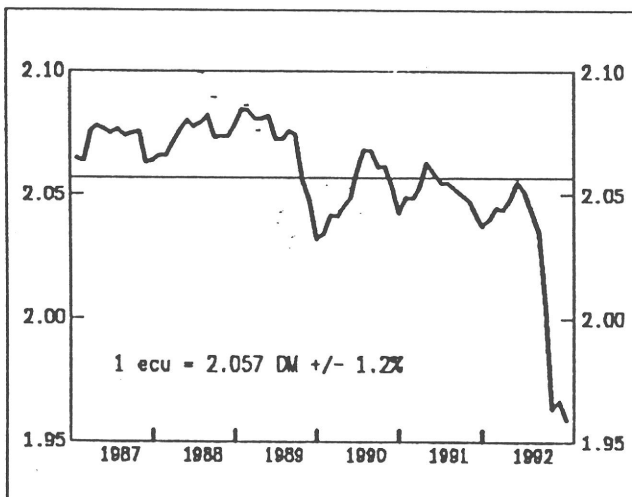
A. EXCHANGE RATE MOVEMENTS
VIS-A-VIS ECU (100 = Jan. 1987).



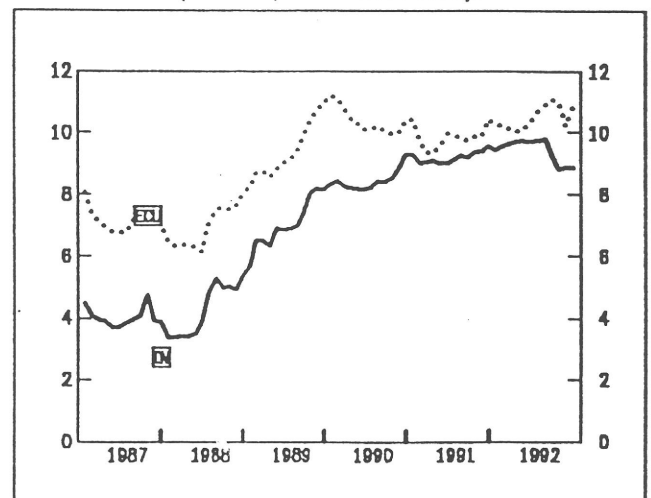
B. INTEREST RATE DIFFERENTIALS
VIS-A-VIS ECU (3 mos, Euromarché).



C. ECU/DM EXCHANGE RATE.



D. ECU AND DM INTEREST RATES
(3 mos, Euromarché).



- 1992 proved to be an unprecedentedly turbulent year for the EMS : in April the escudo joined the 6% band of the ERM; in September the peseta devalued by 5% and the lire and the pound Sterling left the ERM 'temporarily'. By January 1993, however, neither of them has regained the system and, on the 30th of January, the Irish punt devalued by 10% within the system.

- Since the September ERM crisis, not much was left of the growing convergence that had been characterising the European interest rate differentials. At present, two main groups can be distinguished :

* The group including Benelux, Denmark, France and Germany : notwithstanding a slight lowering of interest rates in the Benelux countries, interest rate developments of this group closely moved together.

* The group including Spain, Portugal and Ireland who stayed within the ERM but considerably raised their interest rates (even recently, Ireland raised its overnight rates from 14 to 100%). Spain is considering a lowering of its rates but has not taken any decision yet.

* The United Kingdom has considerably lowered its interest rates since it left the ERM.

- After the ecu lost 3.5% against the DM in September, the DM/ecu rate remained fairly stable during the fourth quarter of 1992.