

International Capital Markets

Developments, Prospects, and Key Policy Issues

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led by
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The following symbols have been used throughout this volume:

. . . to indicate that data are not available;

— to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist;

– between years or months (for example, 1995–96 or January–June) to indicate the years or months covered, including the beginning and ending years or months;

/ between years (for example, 1995/96) to indicate a fiscal or financial year.

"Billion" means a thousand million; "trillion" means a thousand billion.

"Basis points" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to $\frac{1}{4}$ of 1 percentage point).

"n.a." means not applicable.

Minor discrepancies between constituent figures and totals are due to rounding.

As used in this volume the term "country" does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.



Preface

The *International Capital Markets* report is an integral element of the IMF's surveillance of developments in international financial markets. The IMF has published the International Capital Markets report annually since 1980. The report draws, in part, on a series of informal discussions with commercial and investment banks, securities firms, stock and futures exchanges, regulatory and monetary authorities, and the staffs of the Bank for International Settlements, the Commission of the European Union, the International Swaps and Derivatives Association, the Japan Center for International Finance, and the Organization for Economic Cooperation and Development. The discussions leading up to the present report took place in Belgium, France, Germany, Indonesia, Italy, Japan, Korea, Singapore, South Africa, Switzerland, Turkey, the United Kingdom, the United States, and Hong Kong, China, between January and April 1997. The report reflects information available up to the end of May 1997; a special chapter provides an update of exchange market developments in the emerging markets through July 1997.

The *International Capital Markets* report is prepared in the Research Department. The International Capital Markets project is directed by David Folkerts-Landau, Assistant Director, together with Donald Mathieson, Chief of the Emerging Markets Studies Division, and Garry Schinasi, Chief of the Capital Markets and Financial Studies Division. Coauthors of the report from the Capital Markets and Financial Studies Division of the Research Department are Robert Flood, Senior Economist; Marcel Cassard, Peter Christoffersen, Laura Kodres, Alessandro Prati, and Todd Smith, all Economists; Charles Thomas, Visiting Scholar; and Subramanian Sriram, Senior Research Officer. Coauthors of the report from the Emerging Markets Studies Division of the Research Department are Bankim Chadha, Deputy Division Chief; Sunil Sharma, Senior Economist; Ilan Goldfajn, Jorge Roldos, and Michael Spencer, all Economists; and Anne Jansen, Senior Research Officer, and Peter Tran, Research Assistant. Sheila Kinsella, Adriana Vohden, Tammi Shear, and Ramanjeet Singh provided expert word processing assistance. J.R. Morrison of the External Affairs Department edited the manuscript and coordinated production of the publication.

This study has benefited from comments and suggestions from staff in other IMF departments, as well as from Executive Directors following their discussions of the International Capital Markets report on July 30, 1997. However, the analysis and policy considerations are those of the contributing staff and should not be attributed to Executive Directors, their national authorities, or the IMF.



List of Abbreviations

ABS	asset-backed securities
ADR	American Depository Receipt
ASB	Accounting Standards Board (U.K.)
ASEAN	Association of South-East Asian Nations
BAP	Bankers Association of the Philippines
BCCI	Bank of Credit and Commerce International
BIS	Bank for International Settlements
BOT	Bank of Thailand
BSP	Bangko Sentral ng Pilipinas
CAD	Capital Adequacy Directive
CBOE	Chicago Board Options Exchange
CBOT	Chicago Board of Trade
CCPC	Cooperative Credit Purchasing Company (Japan)
CFTC	Commodity Futures Trading Commission
CHAPS	Clearing House Association Payments System
CHIPS	Clearing House Interbank Payments System
CMBS	commercial-mortgage-backed securities
CME	Chicago Mercantile Exchange
CME-IMM	Chicago Mercantile Exchange—International Money Market
CSD	central securities depository
DTB	Deutsche Terminbörse
ECB	European Central Bank
ECU	European currency unit
EEA	European Economic Area
EFFAS	European Federation of Financial Analyst Societies
EMBI	Emerging Market Bond Index (J.P. Morgan)
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	exchange rate mechanism
ESCB	European System of Central Banks
EU	European Union
FASB	Financial Accounting Standards Board (U.S.)
FCDU	Foreign Currency Deposit Unit (The Philippines)
FDI	foreign direct investment
FDIC	Federal Deposit Insurance Corporation (U.S.)
FOBAPROA	Fondo Bancario de Protección al Ahorro (Mexico)
FOGADE	Fundo de Garantiá de Depósitos y Protección Bancaria (Brazil)
G-7	Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States)
G-10	Group of Ten (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom, United States, Switzerland as honorary member)
GBI	Government Bond Index (J.P. Morgan)
GDP	gross domestic product
GDR	Global Depository Receipt
HKMA	Hong Kong Monetary Authority
HKSAR	Hong Kong Special Administrative Region

LIST OF ABBREVIATIONS

IASC	International Accounting Standards Committee
IFC	International Finance Corporation
IFCI	International Finance Corporation Investable index
IOSCO	International Organization of Securities Commissions
ISD	Investment Services Directive
ISDA	International Swaps and Derivatives Association
LIBOR	London interbank offered rate
LIFFE	London International Financial Futures Exchange
MAS	Monetary Authority of Singapore
MATIF	Marché à Terme International de France
MIDAM	Mid-America Commodity Exchange
MLHY	Merrill Lynch High-Yield
NASD	National Association of Securities Dealers (U.S.)
NASDAQ	National Association of Securities Dealers Automated Quotation (U.S.)
NBH	National Bank of Hungary
NDF	nondeliverable forward
NTMA	National Treasury Management Agency (Ireland)
NYFE	New York Futures Exchange
NYSE	New York Stock Exchange
NZDMO	New Zealand Debt Management Office
OECD	Organization for Economic Cooperation and Development
OTC	over the counter
PCA	prompt corrective action
PLMO	Property Loan Management Organization (Thailand)
RTGS	real-time gross settlement
SEC	Securities and Exchange Commission (U.S.)
SET	Stock Exchange of Thailand
SFE	Sydney Futures Exchange
SIMEX	Singapore International Monetary Exchange
SNDO	Swedish National Debt Office
S&P	Standard & Poor's
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer System
TIFFE	Tokyo International Financial Futures Exchange
TSE	Tokyo Stock Exchange
VAR	value at risk
VVA	Valuación y Venta de Activos (Mexico)



I

Introduction

This year's capital markets report reviews developments and trends in the mature and emerging capital markets and banking systems and examines two important policy challenges—the implications of European Economic and Monetary Union (EMU) for financial markets and the management of external liabilities of emerging market countries. A key development in the mature markets was the continued appreciation of the dollar, owing mainly to large capital flows into the onshore and offshore dollar markets and to the relatively strong performance of the United States economy vis-à-vis Europe and Japan. Many of the mature equity markets also advanced further, reaching record highs. In an environment of low inflation and stable growth, investors entered into a broad spectrum of debt markets in search of higher yields, thus contributing to the compression of interest rate spreads that was a prominent feature of most markets. Against the backdrop of continuing globalization of financial markets, a record net inflow into the emerging markets reinforced the compression of borrowing spreads and contributed to surges of activity in domestic securities markets. But this generally favorable financial environment was not without problems, as markets challenged the ability of authorities in some emerging market countries to maintain currency stability in the presence of external imbalances.

The first of the two major international policy challenges discussed in the report concerns the European Union (EU). EU countries are entering into the most significant international financial arrangement since Bretton Woods, the establishment of EMU. It will create a stateless currency, the euro, and a multinational central bank to manage it. As a catalyst for change, the euro can provide impetus to existing initiatives for transforming the nationally segmented European financial markets into one of the largest single-currency financial markets in the world. Such an outcome would secure many of the benefits promised years ago by Europe's single-market initiatives. The opportunities are far reaching, but so too are the remaining institutional and financial challenges (see Chapter III).

The second policy challenge is the need for emerging and transition countries to better manage the risks associated with their external liabilities. The immediate cost savings of borrowing in foreign currencies at

historically low interest rates has not always been met with an appropriate effort to assess and manage the currency and maturity risk of such borrowing. As more emerging market countries become closely integrated into the international financial system the problem of external debt management becomes more pressing (see Chapter V).

The report is followed by two groups of self-contained annexes that provide background material. In Part I, the first annex reviews recent developments in emerging capital markets and also examines recent pressures in selected foreign exchange markets. Annex II provides a survey of recent developments and trends in the mature international capital markets, including foreign exchange, credit, and derivative markets. Annex III is a survey of selected banking systems, focusing on the ongoing process of restructuring and consolidation, supervisory and regulatory developments, and banking system performance in both the mature and emerging market country banking systems.

Part II focuses on three issues. Annex IV examines the implications of EMU for capital markets. It first discusses the size of EU capital markets compared with those of the United States and Japan, and the potential international role of the euro. The annex also describes the institutional framework for cross-border payments, monetary policy, and banking supervision and market surveillance, and the potential implications of EMU for international securities markets and banking systems. Annex V discusses the problem of risk management of external sovereign liabilities. It draws on the experience of countries that have reformed debt management policies and outlines some broad principles for managing the risks inherent in sovereign liabilities, including currency, interest rate, and credit risks. Finally, Annex VI provides some historical perspective on capital flows to the emerging markets. It compares the nature and scale of recent capital flows with those of the gold standard period (1870–1914) and the 1920s, and examines factors that have influenced the scale, composition, and geographic distribution of capital flows to the emerging markets since the 1970s. This annex also reviews recent attempts to identify the key structural and cyclical developments and changes in international financial markets that best explain the resurgence of flows in the 1990s.