

International Capital Markets Update

THE YEARS from 1992 to 1995 were marked by a series of crises in international financial markets; in contrast, the 12 months ending June 1996 have been a period of relative calm. Indeed, the global financial system appears to have emerged stronger and more resilient from the costly and disruptive crises of the earlier years. Financial institutions in most of the major industrial countries have made important progress in implementing reforms to improve their ability to manage and control financial risk. Furthermore, the major industrial countries are continuing to restructure their

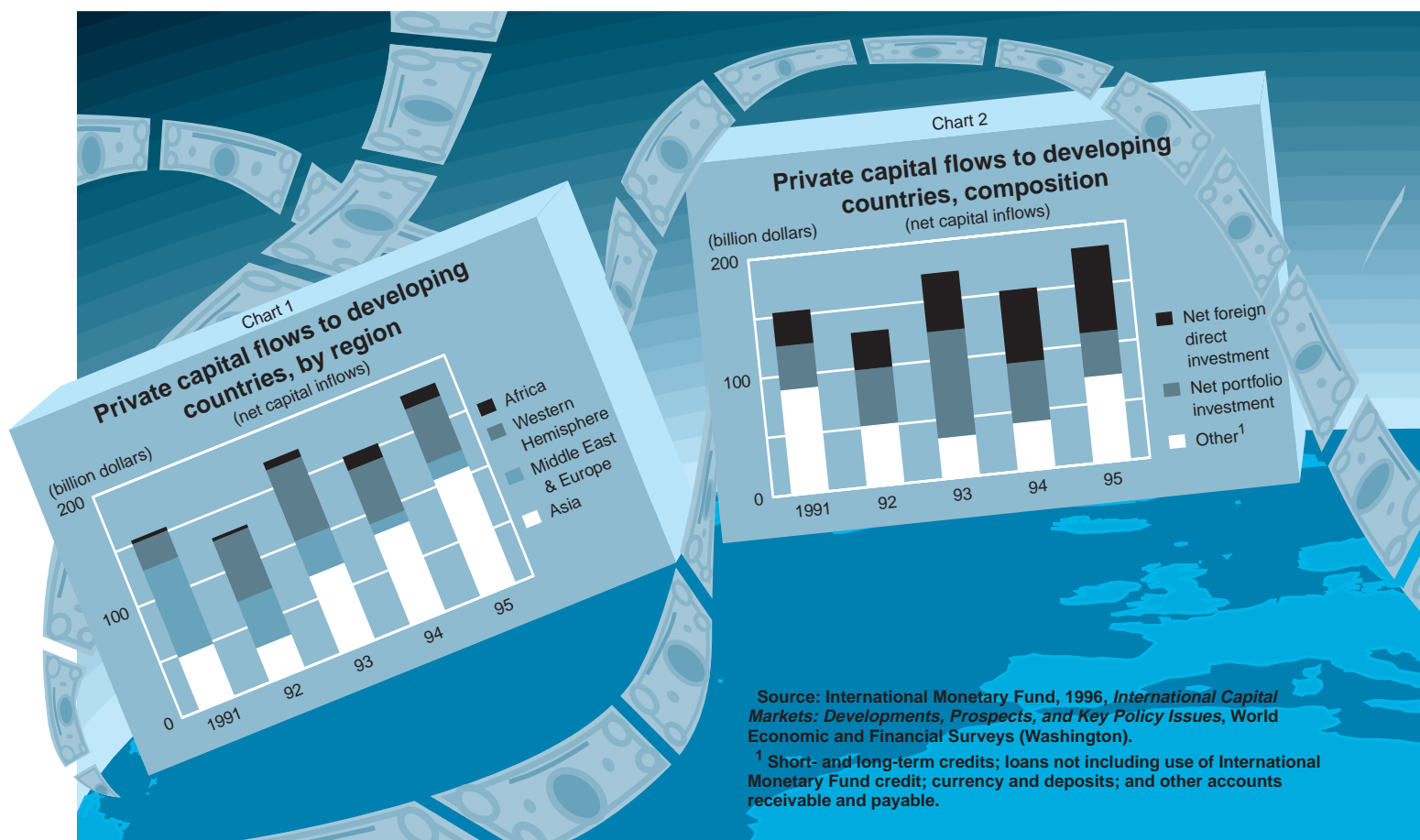
financial, regulatory, and surveillance activities in line with developments in international markets and strengthen market infrastructures, in particular wholesale payment systems. Although much remains to be done, many emerging market countries have also initiated financial reforms to better withstand the vicissitudes of an open international financial environment.

The fruits of these efforts are now visible in recent market developments. Although the scale of financial activity is continuing to grow, market participants, including such risk-tolerant investors as macro-hedge funds, are more disciplined and cautious,

and less likely to ignore market fundamentals, and markets appear better able to shrug off periods of turbulence, at least for now.

Recent crises appear to have been the inevitable by-product of the transformation and restructuring of international finance that has taken place during the past ten years. This transformation has forced both official and private participants in international financial markets to adapt quickly in order to better manage the private and systemic risks posed by these developments.

Although the fallout from the Mexican financial crisis has not entirely disappeared,



capital flows to the emerging market countries have returned to levels attained prior to the crisis, and international investors are exercising greater discrimination among regions (Chart 1) and among different types of assets than had been evident before the crisis. Nevertheless, a rapid increase in the issue of yen- and deutsche mark-denominated bonds raises questions regarding the ability of some emerging market countries to manage currency exposures prudently, and it also calls into question the ability of retail investors to adequately assess sovereign credit risk. A certain amount of volatility in capital flows is inevitable, but the changing composition of these flows (Chart 2) indicates a reduced risk of sudden large-scale withdrawals from developing countries.

Meanwhile, the major international financial markets returned to a state of relative calm in the second half of 1995 after a period of adjustment that began in early

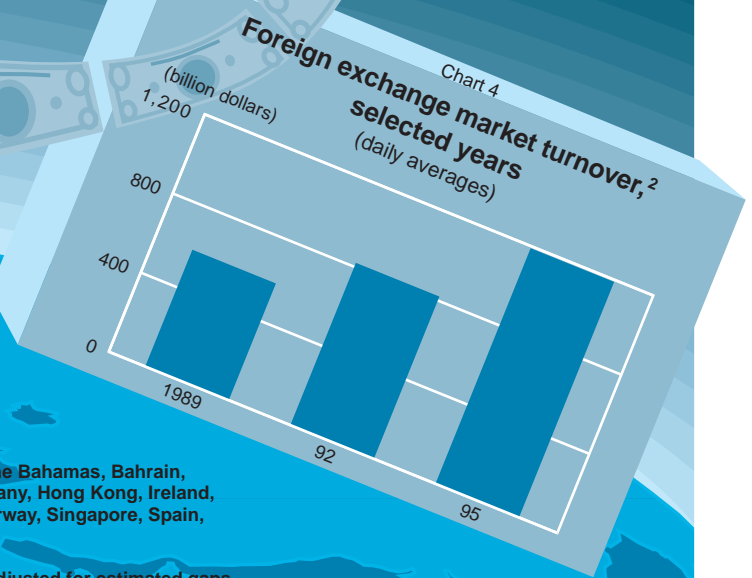
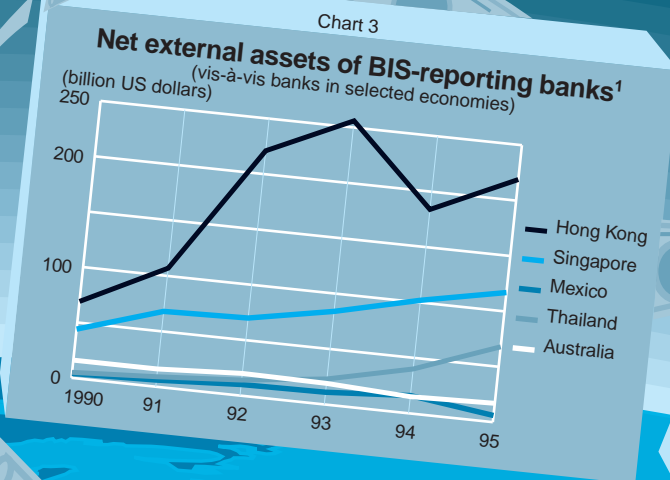
1994 with bond market turbulence and ended in mid-1995 with the elimination of a temporary misalignment of the major currencies. Apart from occasional volatility, markets have remained calmer in 1996, in part also because the macroeconomic environment has been supportive of more stable financial markets.

Two remaining financial policy challenges must be met to ensure the stable evolution of the international financial system. The first challenge is how to extend the successful supervisory and regulatory practices developed under existing Group of Ten multilateral arrangements to include the growing number of systemically important emerging market countries (Chart 3). The continuing globalization of financial markets, now extending gradually to this group of countries, will increasingly demand a more inclusive multilateral approach. The second, and more technical, challenge is how to reduce further the

potential for disruptions in the global foreign exchange market—the core of the international financial system—where turnover now exceeds \$1 trillion a day (Chart 4).

Efforts to facilitate clearance and settlement of foreign exchange transactions, as well as to reduce outstanding settlement balances, are being given top priority by the major central banks, and several related initiatives are currently being undertaken by the major foreign exchange dealers. There does appear, however, to be scope for greater official involvement in meeting this challenge. **F&D**

This article is drawn from International Monetary Fund, 1996, International Capital Markets: Developments, Prospects, and Key Policy Issues, World Economic and Financial Surveys (Washington).



Source: Bank for International Settlements.

¹ BIS-reporting banks are banks in the following economies: Austria, the Bahamas, Bahrain, Belgium, Canada, the Cayman Islands, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Luxembourg, the Netherlands, the Netherlands Antilles, Norway, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

² Global estimated turnover, which is the number reported to the BIS, adjusted for estimated gaps in reporting and for local and cross-border double counting ("net-net" basis).