THE INTERNATIONAL CAPITAL MARKET

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The history of the Eurobond market and its rapid development since its inception in the early 1960s is well documented. In its short life the market has been subjected to many different and sometimes conflicting influences; throughout it has exhibited extraordinary flexibility. It is this flexibility which has enabled it to survive and mature into a truly international capital market. Though by natural evolution it will inevitably undergo various changes in form, it is, I believe, here to stay as an important part of the financial scene.

The period 1969–70 has so far been probably the most critical and, at the same time, the most instructive of the market's adolescent years. This period has been characterised by currency uncertainties, by the unusual spectacle of continued inflation side by side with recession in many industrialised countries and by the eclipse—at any rate for the time being—of the 'equity cult'. In this article I propose to examine the evolution of the international market in the most recent past and, perhaps rashly, to draw some tentative conclusions as to its likely development in the immediate future. Finally, and at the risk of exposing myself to the charge of repetition, I shall stress once more what I have pointed out on several previous occasions, namely the need for some form of regulation of the new issue side of the market.

The past one to two years

In August 1969 the pressure on the French franc was relieved by its devaluation, but the parity of sterling continued to be suspect until some real evidence of a change in our trading position began to emerge towards the end of the year. In the meantime, as a result of the advantage in the rate of inflation enjoyed by Germany as compared with her major trading partners, speculative purchases of the Deutschemark built up until the German authorities were compelled, first, to allow their currency to float in relation to the dollar, and subsequently, to adopt a new parity resulting in an effective revaluation of just under 10 per cent.

These events had two main effects on the international market. In the first place, the rapid growth of the German foreign exchange reserves in the early months of 1969 was a source of some embarrassment to a German Government reluctant both by temperament and for domestic political reasons to revalue the German currency unilaterally. The German authorities therefore evolved a policy to encourage the export of capital through the issue on behalf of foreign borrowers of bonds denominated in Deutschemarks; in 1969 such issues accounted for 40 per cent of all international issuing activity in Europe as against 23 per cent in the previous year and 10 per cent in 1967. This surge of activity, which brought the major German banks into the market as leading managers of international issues, was encouraged by a propensity on the part of many investors to seek securities denominated in a 'hard' currency, particularly in one which might give rise to a speculative gain. In the aftermath of the revaluation of the Deutschemark in November 1969 selling pressure on internationally-syndicated Deutschemark bonds built up rapidly. It was therefore apparent that these bonds had become the repository for 'hot money' which—were it not for the stringent reserve requirements placed on deposits with German banks by non-residents—might have more naturally been held in liquid form.

The second principal effect of the 1969 currency scares was to keep interest rates in the short-term Eurodollar market at extremely high levels. This reflected the operations not only of currency speculators but also of commercial concerns who wished either to speculate on a revaluation of the hard currencies—particularly the Deutschemark and the Swiss franc—or, quite legitimately, to cover liabilities incurred in such hard currencies. The persistence of high interest rates—at one point in July the inter-bank rate for six-months Eurodollars was over 12 per cent—and investor preference for issues denominated in hard currencies aggravated conditions in an already over-burdened market for long-term issues denominated in dollars and with no equity content as a potentially redeeming feature. It again became apparent that the pool of funds available for such issues is limited. On more than one occasion the new issue market broke down completely as several issues were thrown on to it with little regard for its capacity to absorb them. Long-term interest rates spiralled and activity in the secondary market fell sharply as dealers became increasingly reluctant to take large positions and suffer the resulting losses.

Meanwhile the 'equity cult' had become rather accentuated and continued late into 1969. Consequently investors absorbed large quantities of bonds with an equity feature, often without due regard for the quality of the underlying earnings or the reasonableness of the price/earnings multiple or the soundness of the asset and liquidity positions. Out of the 60 per cent of total issues denominated in dollars in the year 1969, over 65 per cent had some equity feature.

After the revaluation of the Deutschemark it was widely hoped that we could look forward to a period of relative calm on the currency front. This hope was furthermore encouraged by the adoption of the Special Drawing Rights scheme by the International Monetary Fund early in 1970 and the first allocation of SDRs. In recent months, however, currency fears have once more come to the fore. While sharp increases have taken place in the foreign exchange reserves of such countries as Germany, Holland and Japan, where the rate of inflation is, relatively speak-