THE

EUROCURRENCY MARKET HANDBOOK

Second Edition

Dr. Eugene Sarver

NEW YORK INSTITUTE OF FINANCE

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Preface

This book provides a detailed overview of the full scope of the Eurocurrency market. The manifold analyses were initially developed in conjunction with my instructional responsibilities in Chemical Bank (Bahrain and Mexico City) and Credit Lyonnais financial training programs, as well as in teaching positions at the New York Institute of Finance, the American Institute of Banking, and the Lubin Graduate School of Business, Pace University.

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Eugene Sarver

Introduction

In this dynamic era of global banking and brokerage networks, woven ever more tightly together by S.W.I.F.T., CHIPS, Reuters, and Telerate (and soon GLOBEX), banking increasingly means *international banking*. In turn, international banking means not the traditional foreign banking of accepting deposits from and extending loans to nonresidents in a bank's domestic currency; rather, it usually means banking activities conducted in foreign currencies, that is, Eurobanking, or more broadly, the Eurocurrency market.

A *Eurocurrency* is simply a currency on deposit outside its country of origin (or a dollar on deposit at an International Banking Facility or IBF in the United States, or a yen on deposit in the Japan Offshore Market or JOM). Such deposits are also called *external currencies, international currencies,* and *xenocurrencies* (*xeno* meaning "foreign" in Latin, as in xenophobia). However, the term "Eurocurrency" is preferred, its etymology being traceable to one of the original banks in the market, the Banque Commercial pour l'Europe du Nord, best known by its cable code, EUROBANK. Also, the original locus of the Euromarket was in Europe (especially London), reinforcing use of the term "Eurocurrency."

Reflecting the preference to conduct banking as free as possible from reserve requirements, interest rate ceilings, deposit insurance fees, capital export controls, legal lending limits, limits on bank assets growth (such as the UK corset), mandated credit allocations, capital: asset ratio requirements, liquidity ratios, and multiple tax authorities, the gross size of the Eurocurrency deposit market has grown to equivalent of approximately $5,000 billion, nearly doubling its size in the past five years. The Eurodollar market accounts for 60% of it, and much of the balance is Euro-Deutschemarks (15%) and Euro-Yen (6%). However, there are also significant Euromarkets in Swiss francs, British pounds, French francs, Dutch guilders, Canadian dollars, Belgian francs, Italian lire, ECUs, Australian dollars and Danish krone. Including other Euro-instruments results in a market well over $5 trillion.

While domestic banking and Eurobanking inevitably have much in common, their asset and liability profiles are nevertheless so distinct that Eurobanking must be considered a separate market. Exemplifying the distinctions are the U.S. dollar domestic and Euromarkets.

Domestic banking *liabilities* tend to be rather diverse, often of indeterminate maturity, noninterest-bearing (demand deposits) or low interest-bearing (NOW accounts), and emphasize negotiable CDs (not term Fed funds) for maturities beyond a few weeks. Eurodollar liabilities are predominantly time deposits (to a moderate extent, negotiable CDs) and are all interest-bearing, with fixed maturities.

Concurrently, domestic bank *assets* are generally loans priced on a floating prime rate (or money market) basis, extended by a single bank to a corporate borrower. Typically, Eurobanking assets are syndicated loans, repriced on a three- or six-month rollover basis (London Inter-Bank Offered Rate or LIBOR), offered by an international group of banks to a sovereign borrower or multinational corporation. Multicurrency funding and lending options, with the associated foreign exchange risks, further widen the differences between the domestic and Eurocurrency markets.

The Eurocurrency Market Handbook sequentially treats the principal aspects of that central sphere of international finance. *Section 1* statistically presents the immense scope of the Eurocurrency market, its remarkable growth over the last 25 years, its major currency segments, and other key characteristics, such as participant and maturity profiles. Also, the principal statistical monitor of the Euromarket, the Bank for International Settlements, or BIS (Basle, Switzerland), is profiled. *Section 2* chronicles the historical development of the Eurocurrency market, and the implications of Europe 1992, focusing on the factors that have promoted its unprecedented expansion.

Next, *Section 3* scrutinizes the critical and ancillary factors that have propelled certain financial centers to global banking significance. Complementing that theoretical perspective is an examination of several major centers such as London, Luxembourg, Paris, New York, Cayman, Nassau, Tokyo, Singapore, Hong Kong, and Bahrain. New centers added in the *Revised Edition* include Madrid, Dublin, Gibraltar, Monaco, Cyprus, Isle of Man (Douglas), Malta, Madeira (Funchal), the United Arab Emirates (Dubai, Abu Dhabi), Beirut, Liberia (Monrovia) and Mauritius (Port Louis).

Section 4 then focuses on the principal Eurocurrency deposit markets in terms of their disparate characteristics, highlighting their distinct interest rate levels and structures. Additionally, the Eurocurrency markets are compared with their corresponding domestic markets, especially from the perspective of impediments to arbitrage. Finally, the twelve major non-U.S. dollar Eurocurrency markets are studied in terms of their historical development, market participants, interest rate factors, and interest rate movements from 1976 to 1990. The Eurocurrency markets examined include those in Deutschemarks, Swiss francs, Japanese yen, ECUs, pounds sterling, French francs, Dutch guilders, Belgian francs, Italian lire, Canadian dollars, Australian dollars, and Danish krone.

Next, *Section 5* details interbank Eurocurrency trading and related brokering, both in terms of intracenter and intercenter transactions. While *Section 6* presents a complementary look at the principal Eurocurrency market instruments (aside from the dominant one of nonnegotiable time deposits), including fixed and floating rate negotiable CDs, Eurodollar and Eurocurrency differential futures and options contracts, and Euronotes (including Eurocommercial paper and medium-term notes or MTNs), and interest rate and currency swaps. Also, the new international computerized trading system, GLOBEX, is previewed.

Section 7 then details the principal ultimate asset of the Euromarket, the syndicated Eurocurrency loans. An exposition of the syndication process is followed by a detailing of the elements of Eurocurrency credits, and a statistical breakdown, by region and individual countries, of such bank credits, as well as international bonds from 1983 through September 1989. A description of the global debt crisis and proposed solutions such as the Baker Plan and the Brady Plan, and the secondary market in third world debt, is included. Finally, descriptions of the "watch group" for the syndicated loans spawned by the crisis, the Institute of International Finance, and the negotiation group for government and government guaranteed loans, the Paris Club, are included as well.

Section 8 provides insight into the elusive concept of Eurocurrency market supervision with the full 1975 and revised 1983 BIS *Reports on the Supervision of Banks' Foreign Establishments.* Especially noteworthy are the distinctions between branches, subsidiaries, and joint ventures (consortia), as well as the concern with the related but separate problems of liquidity, solvency, and prudent foreign exchange management. Also, the historical 1980 *communique* by the Bank for International Settlements on the Eurocurrency market is included. Two additions in the *Revised Edition* are the Basle Agreement among the G-10 countries plus Luxembourg and Switzerland on uniform, international, risk-adjusted minimum bank capital:asset ratios, and the supervisory implications of the Citibank-Wells Fargo Manila Eurodeposit dispute.

Finally, *Section* 9 provides current statistical information (through the third quarter of 1989) comparing the Eurobond and Eurocurrency bank credit market. While the Eurobond market has been traditionally secondary to the Eurocurrency bank credit market, it made a strong showing in 1983 ($49 billion vs.. $74 billion) and 1984 ($80 billion vs. $113 billion) surpassed it in 1985 ($137 billion vs. $110 billion), and forged well ahead in the year ending September 1989, when new issues totalled $248.6 billion as it offers lower costs to qualified borrowers. A description of the Eurobond market is provided, as well as tables analyzing the market in the 1988–1989 period in terms of type of issue (such as fixed rate), currency, and issuers by nationality. The section concludes with a description of the secondary Eurobond market, including the recent problem with perpetual FRNs, and the Eurobond market clearers Euroclear and Cedel, including their present conflict.

The book concludes with 21 appendices, including a glossary and a chronology of the Euromarket. The 14 new appendixes in the *Revised Edition* includes "Eurocurrency Databases On-Line," "1990 Expatriate Cost-of-Living Indices for Global Banking Centers," and "Schedule of IMF/World Bank Annual Meetings: 1985–1993."

Contents

3
Eurocurrency Banking Centers, 67

4
Principal Nondollar Eurocurrency Markets, 273

5
Interbank Eurocurrency Trading, 333

6
Eurocurrency Market Instruments, 355

7
Syndicated Eurocurrency Bank Credits, 399

8
Eurocurrency Market Supervision, 445

9
The Eurobond Market, 467

Appendixes, 507

1

Eurocurrency Market Size and Profile

Most of the data available on the Eurocurrency market is collected by the Bank for International Settlements (BIS), in particular by its Monetary and Economic Department. Its most useful publication is its quarterly *International Banking and Financial Markets Developments.* Additional publications are its semiannual report (jointly with the Organization for Economic Cooperation and Development (OECD)) on external indebtedness and its *Annual Report* (April 1–March 31, and published in mid-June), which provides an independent analysis of monetary and economic developments. (A second source, less broad in scope, but very up-to-date is the monthly *International Financial Statistics* or *IFS* of the International Monetary Fund.)

Bank for International Settlements

The Bank for International Settlements in Basle, Switzerland, was founded pursuant to the Hague Agreements of 1930. Its special role is to promote the cooperation of central banks, and to fulfill the function of a "central banks' bank." Although it has the legal form of a company limited by shares, it is an international organization governed by international law, and enjoys special privileges and immunities in keeping with its role (a Headquarters Agreement was concluded with Switzerland in 1987). The participating central banks were originally given the option of subscribing to the shares themselves or arranging for their