

practice that is forbidden by law in the United States. Any estimate of the volume of dollar deposits placed in the market rests on tenuous grounds, but the total is believed to exceed \$1 billion. Since many European banks that obtain dollar deposits in this market redeposit these funds with other banks (i.e., act as intermediaries), the overall volume of dollar interbank deposit claims outstanding abroad may well be a multiple of the amount cited above. Variations in the volume of trading are, however, sizable, since the market is highly fluid, being directly influenced by shifts in national monetary policies, by changes in bank liquidity, and by changes in international interest and exchange rate differentials. A market of this size and scope clearly warrants examination, particularly because of its implications for the position of New York City as an international financial center, for the dollar as a world currency, and for the European banking and money market structure.

HISTORY OF THE MARKET

The original impetus for the postwar development of the continental dollar market is believed to have arisen from the desire of several banks in Eastern Europe to leave their dollar balances with their correspondents in France and England rather than carrying them in their own name in the United States. In making use of these and other dollar balances, the correspondent banks found a number of outlets, often involving the offer of these funds to foreign banks in need of dollar finance, at rates somewhat lower than would be paid for credits from U.S. banks. Before long other holders of dollar balances took advantage of the growing demand for this relatively inexpensive dollar accommodation, and soon an active market for dollar deposits began to develop, notably in Paris and London.

Further stimulus was given to the market in the fall of 1957 when sterling came under pressure. At that time, the British authorities put restrictions on the use of sterling for the refinancing of foreign trade credits to nonresidents; they also banned sterling acceptance credits covering trade between countries outside the sterling area. British banks then offered their customers and correspondents dollar facilities to take the place of the prohibited sterling credits, obtaining the requisite balances in the continental dollar market. Toward the end of 1957, and particularly in the spring of 1958, the new demand met with a rapidly increasing supply, as sizable European acquisition of dollars, and easier credit conditions internally, brought many European banks into the market in search of attractive outlets for their surplus funds.

By mid-1958, the market was well established, but it did not assume really impressive proportions until the end of that year when rates paid abroad for dollar deposits rose well above the maximum interest rates that banks in the United States were permitted to pay for time deposits under Regulation Q of the Board of Governors of the Federal Reserve System. Many European banks that had been reluctant to enter the market on a large scale then became active participants on the supply side.

The introduction of nonresident convertibility throughout Western Europe at the end of 1958, as well as the further relaxation of exchange controls in some countries, also contributed to the broadening of the continental dollar market. The emergence at that time of a fully integrated and active foreign exchange market enabled banks to take in deposits denominated in foreign currencies, "swap" them into dollars, and use the dollars for investment in the continental dollar market. (In such a swap transaction the foreign currency deposit is used to purchase dollars "spot"—i.e., for immediate delivery; and simultaneously, so as to hedge against adverse exchange fluctuations, dollars are sold "forward" for delivery and payment at about the time the foreign currency deposit must be repaid.) In several countries, moreover, banks were permitted freely to swap their own currencies into dollars.

By 1959, the Dutch, Swiss, Scandinavian, and for a limited period the German banks had become the source of substantial funds offered in the market. During the course of the year several central banks in Europe and southern Asia, as well as some banks and other holders in the oil-producing areas of the Near East and even private corporations including foreign subsidiaries of U.S. companies, joined the ranks of the suppliers. On the demand side, in particular Italian, French, British, and Canadian banks, as well as branches of U.S. banks abroad, and more recently German and Japanese banks became important participants. The market had thus become less and less a strictly European affair and had assumed worldwide proportions and ramifications.