

THE MECHANICS OF THE MARKET

For a full understanding of how the market operates, it is important to note that it is only a part of the international market for short-term funds that has emerged in Europe since convertibility. Many European banks stand ready to accept deposits in a number of foreign currencies—pounds sterling, Swiss francs, German marks, Dutch guilders, as well as dollars. The dollar deposit market is by far the most important, however, for a number of reasons. First of all, the dollar is the leading international currency. Second, it has been readily available in large amounts in the foreign exchange markets, a reflection of our balance-of-payments deficit during the past decade. Third, the dollar is virtually the only currency used by European central banks as a reserve currency. Their operations in the exchange market to stabilize the value of their own currencies are conducted, under the European Monetary Agreement, exclusively in dollars. Consequently, central banks are always residual buyers or sellers of dollars in the exchange market.

As already pointed out, suppliers of dollar deposits sometimes acquire them by converting other foreign currency deposits into dollars. Similarly, an acceptor of a dollar deposit may not necessarily use it for lending or investing in the form of dollars. If the constellation of interest and forward exchange rates among various centers makes it profitable to switch the dollars into another currency for lending or investment, many European banks will be quick to do so. The continental dollar market is thus closely integrated through an intricate maze of operations with the full complex of European money and exchange markets.

The continental dollar market is a true market in the sense that there are a large number of banks who stand ready either to accept or to supply dollar deposits at any given time with only a small spread in the rates involved. In many cases, banks will accept dollar deposits from a correspondent bank, not because they have a need for dollars, but to further customer relationships or for some other reason. In some cases, they are willing to redeposit the dollars with another bank with no spread over the interest rate which they themselves are paying. Intermediaries, too, may at times make redeposits at no spread in rates in order to keep their names in the market.

There is a regularly quoted rate for dollar deposits within Europe. At the end of October, for example, deposits on 24-hour notice were quoted in London at $3\frac{1}{8}$ percent, 1-month deposits at $3\frac{3}{4}$ percent, and 3-month deposits at $3\frac{7}{8}$ percent. As would be expected, the dollar deposit market is an interbank market with transactions handled by a bank's exchange traders, although activity is closely linked with the bank's money position. In many European banks the manager of the bank's money position is also the chief foreign exchange trader, a practice which is virtually unheard of in the United States and which indicates the close link in Europe between money and foreign exchange markets. Transactions are carried out largely by telephone, but also by teletype or cable. Some banks regularly solicit deposits by mail. While, as in all markets, the amount that can be readily transacted at quoted rates may vary from time to time, it is normally possible for a prime name to place or receive deposits in blocks of \$1 million or substantially more in a few minutes' time. Rates may, however, vary quite considerably according to the names and countries involved (as discussed in the next section of this article).

A sizable part of the activity appears to take place in short-dated deposits—on 24-hour or 7-day notice. Often, however, deposits may be made at short-term with an understanding that they will not be withdrawn for longer periods save for exceptional developments. In other cases 1- or 3-month deposits may be subject to prior withdrawal in unusual circumstances.

It should be made clear that these transfers of dollar deposits among European and other banks and their subsequent use do not usually result in the extinguishing of dollar deposits in American banks. Such transfers are usually effected by means of a cable from foreign bank holding a dollar account in a U.S. bank instructing the latter to transfer funds to the account of the foreign bank accepting the deposit, either in the same or another U.S. bank. What happens subsequently depends on the uses to which the bank accepting the deposit puts the money. Ownership may pass from foreigner to foreigner, or from a foreign account to a U.S. account if the dollars are eventually loaned to an importer abroad who makes payment to a U.S. exporter. Ownership may change, but the deposits ordinarily do not "disappear." Exceptions to this general rule occur