

they perform in bringing suppliers and seekers of dollar deposits together. Most banks serve as principals in this capacity—i.e., they accept deposits in their own name and then redeposit with other banks, earning a small spread (up to one-eighth of 1 percent) on such operations, although as mentioned earlier they may sometimes operate on a “flat” basis. They may also deposit with banks with lesser known names—or with banks with urgent needs—at a somewhat greater spread, reflecting the somewhat greater risk involved. Intermediary banks thus serve as a channel between the more conservative banks and a very large number of banks that are users of dollar deposits.

Because of their closeness to the foreign exchange market and the volume of transactions that they handle, the intermediary banks are quick to take advantage of any opportunities to engage profitably in swap transactions. They may, for example, accept Swiss franc deposits, swap the Swiss francs for dollars, and then deposit the dollars somewhere else; in turn, these dollars may be swapped into sterling or some other currency. An extremely large volume of foreign exchange transactions, both spot and forward, has resulted from these operations.

In addition to intermediary banks, who act as principals in the market, other banks may act on a brokerage basis as a service to correspondent banks. Foreign exchange brokers in both London and Paris also handle dollar deposit transactions in some volume on a brokerage basis.

The leading center for the continental dollar market is London, where a considerable number of banks—merchant banks, foreign banks, and British overseas banks—serve as intermediaries in accepting and putting out foreign exchange deposits quite apart from using the deposits acquired for their own trade financing needs and for other ordinary banking transactions. Banks in other centers—Paris and Milan, for example—have been doing a fairly substantial business in “jobbing” dollar and other deposits.

DEMAND PATTERNS

A feature of the market is the very diverse use to which the ultimate receivers put the deposits. Many acceptors of deposits employ them as loans to customers for the financing of imports from the dollar area or elsewhere. Substantial balances are also employed for loans to securities dealers and brokers in New York, and branches abroad of New York banks are in the market to obtain time deposits for use by their head office. Some banks convert dollar deposits into their own currencies and employ them for loans and investments in their own credit and money markets, and still others acquire dollar and other deposits in order to place them in other money markets at a profit.

International trade financing appears to absorb a substantial part of the total of dollars offered in the continental dollar market. Banks in Italy until last summer entered the market heavily for this purpose, but in recent months have become primarily intermediaries. French, Japanese, British, German, and some governmental banks in Eastern Europe have also taken advantage of the market in order to put their foreign traders into funds at rates substantially below the cost of acceptance financing or direct loans in New York. Even trade in the Middle East and southeast Asia has been financed with continental dollars, often through Beirut.

Italian banks resorted to dollar (and other foreign currency) financing of foreign trade on a large scale because they could thereby compete more effectively for new customers. Interbank competition in Italy has long been stifled by rate agreements with respect to lira credits. Until 1959, rates for foreign currency loans, not a factor of any consequence during the period when dollars and other hard currencies were in short supply, were not so regulated. Thus, lending in dollars permitted a wide breach in the highly regulated Italian loan rate and commission structure. (More recently, however, there has apparently been some moderation of this intense interbank competition, but rates on dollar loans remain substantially below those for lira loans.)

In order to offer present or potential customers the lowest possible rates, Italian banks have taken full advantage of interest rate-forward exchange rate constellations. For instance, an Italian bank might have a customer who wished to borrow sterling to finance an import from the United Kingdom. The bank might then take advantage of the facilities of the continental dollar market to arrange to receive a deposit, say, from a British bank, of a corresponding amount of dollars. It would then seek out an opportunity to reduce its borrowing costs by making a profitable swap—i.e., if the forward dollar were at a discount