

The continental dollar market also has had the effect of sharply increasing the volatility of some foreign dollar balances. As noted above, substantial amounts of dollar deposits offered in the market represent balances that previously had been held in the form of time deposits with U.S. banks. True enough, the balances underlying the continental dollar market ordinarily remain in U.S. banks as demand deposits. But there is a great difference for a New York bank between a firmly lodged foreign time deposit, with its relatively low reserve requirement, which may be invested in relatively high-yielding loans or investments, and demand deposits that foreign banks manage and employ actively. As such balances are drawn upon by their foreign owners and transferred to other banks abroad who in turn redeposit them or otherwise make use of them, the volatility of these deposits tends to be high—a definite disadvantage to the U.S. depositories in the management of their own money position.

Although the continental dollar market has somewhat reduced the importance of New York as an international lending center, it has added to the importance of the dollar as an international currency. Perhaps the greatest attraction of the continental dollar market to lenders derives from the fact that it offers opportunities for very short-term investments at rates substantially in excess of those available elsewhere. In fact, it permits dollar depositors to earn interest on demand deposits—which is, of course, not possible in the United States. The covariation of interest rates in the continental dollar market and the New York money market appears to be quite close, except in periods of very easy conditions in the New York money market. Rates for continental dollar deposits for 3 months, as quoted by London merchant banks, are usually considerably above those for U.S. Treasury bills and bankers' acceptances, while 1-month deposit rates are always substantially above U.S. Treasury bills with 1 month to maturity. The prevailing rate differentials in part reflect, of course, investment quality differences, but the fact remains that the continental dollar market has given birth to a new relatively high-yielding and now firmly entrenched and widely used outlet for the short-term investment of dollar funds. In this sense the dollar has become more useful, and banks operating in this market will probably tend to hold on to dollar assets for more extended periods than they would in the absence of the market.

In conclusion, a few words about the repercussions of the market in the European banking and money market structure. Lending of dollars and other deposits to importers has importantly contributed to interbank competition in Italy and France. Another significant effect of the market is the relatively easy access to foreign exchange resources that it has afforded to smaller European banks. At a price, they can within broad limits secure additional dollar and other currency deposits and thereby free themselves of the limitations of their domestic resources. This has further contributed to interbank competition in the countries concerned.

On a broader plane, the easy access of banks to deposit balances abroad has given an additional spur to the intermeshing of money markets throughout Europe. Even without the development of the continental dollar market, the increased freedom with which funds have been permitted to move from one market to another in recent years has been a major force contributing to the interlinkage of national money markets. But the ability of banks to enter an established market for dollar deposits, and thus to obtain on their own initiative funds that they may swap into other currencies, has made for even closer integration. By the same token, the succession of interdependent short-term claims imposes risks of vulnerability, since the liquidity of each participant in the market becomes in part dependent upon the ability of the ultimate borrowers to meet their obligations.

Mr. KLOPSTOCK. The Euro-dollar market had various effects on the U.S. balance of payments. On balance, I believe the market has been beneficial to our international financial position. The interest of foreigners in holding on to dollars or purchase dollars has increased because the market offers a profitable investment outlet to foreigners for dollars. They can earn attractive interest rates by placing dollar deposits in this market.

Senator PROXMIRE. What is the Euro-dollar? Isn't it just a dollar that the Europeans hold?