L.5.2 RFD 658

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

September 8, 1970

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The New Euro-Dollar Market in Asia 6 Pages

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The New Euro-Dollar Market in Asia

Primarily as a result of the leadership of the Bank of America, a Euro-dollar type operation has been established in Singapore. This was chiefly made possible by the Singapore government's elimination of withholding taxes on non-residents' earnings from convertible currency deposit accounts. Although still relatively small, the market is likely to continue to grow in the future, and it has brought about a closer integration of Singapore with the various international money markets.

Sponsors of the New Facility and Basic Objectives

In the spring of 1968 the Bank of America first began to formulate plans for establishing in Singapore what has popularly become known as the Asian dollar market.1/ Of three possible locations--Japan, Hong Kong, or Singapore--the last appeared to be the most advantageous place to establish the market. Japan was not very suitable because of its controls on foreign exchange transactions, and Hong Kong was not advantageous because both residents and non-residents are subject to a Hong Kong withholding tax on their interest earnings. The Singapore Government, on the other hand, had revised its local income tax law in August of 1967 and had eliminated its withholding tax on the interest income from deposits of non-residents.2/ In addition, Singapore, for many years, has had no restrictions on the inward or outward remittance of funds, including interest. The Singapore market also has the advantage of a central location between the Far East and Southern Asia, both in terms of the Asian communications network and geographically in terms of surface travel.

The Singapore market in Euro-dollars was first established in January of 1969 after the Singapore branch of the Bank of America received a special license from the Singapore Government to operate and maintain convertible foreign currency accounts. Several months

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1/ From a technical point of view, the "Asian dollar market" is actually an extension of the Euro-dollar market to Singapore, and it is not really different--except in a geographical sense--from what is sometimes called the "Euro-dollar market" in, say, Canada or Lebanon.

2/ In a country with a 15 per cent withholding tax on interest payments, for example, a gross interest rate of 8 per cent becomes a net interest rate of 6.8 per cent if the depositor cannot recoup the withholding tax.

later, the Singapore branch of the First National City Bank of New York also began to solicit and accept foreign currency deposits. By the spring of 1970, a total of 12 commercial banks in Singapore had been licensed to borrow and lend Euro-dollars and other foreign currencies.

According to its commercial bank sponsors, the basic objective in establishing this new market has been to mobilize foreign currency funds with the purpose of using them to provide medium-term development loans to Asian enterprises.1/ However, the market has so far channeled only a relatively small amount of funds to business enterprises in the region, a feature that will be discussed in more detail later. Japanese bankers reportedly believe that the new market largely represents an effort by American bankers in Singapore to attract overseas Chinese, and other Asian, capital that is now mainly deposited in European banks.2/

Nature of the Facility

The new facility basically consists of convertible foreign currency deposit accounts in those commercial banks in Singapore licensed by the Government to operate and maintain such accounts. The banks are required to establish these accounts as an independent unit, completely separate from the banks' other accounts. Deposits denominated in the specified currencies may be made only by persons and institutions resident outside of Singapore.

At present, the banks licensed to maintain these accounts accept only a minimum deposit of U.S. $25,000 (or its equivalent), with a minimum maturity of one month. In Europe, on the other hand, Euro-dollar deposits are accepted for as short a period as overnight, with no generally established minimum size of deposit, although London (negotiable) dollar certificates of deposit are not issued in amounts smaller than U.S. $25,000. Although Singapore did not have a secondary market in negotiable certificates of deposit through August of 1970, the Ministry of Finance did approve in mid-1970 the issuance of such certificates. The Government has also recently authorized the establishment by commercial banks of secret numbered accounts in certain cases.3/

1/ Far Eastern Economic Review, Hong Kong, October 23, 1969, p. 237.
2/ Journal of Commerce, December 8, 1969, p. 7.
3/ The Financial Times, London, August 18, 1970, p. 8.

For these foreign currency accounts, the licensed banks are required to observe the minimum 20 per cent liquidity ratio required of commercial banks, but the banks are exempt from the requirement that they maintain at least 3.5 per cent of their deposit liabilities in cash reserves with the Accountant-General.1/

Various estimates indicate that about 95 per cent of the funds deposited so far in these accounts consist of United States dollars. The balance reportedly consists mainly of Deutsche marks, Swiss francs, and Japanese yen.

One advantage which Singapore has in operating this new market in Euro-dollars is that there is only a six-hour time difference with London. This means that the banks in Singapore are open for business during part of their working hours at the same time as the ones in London and hence are able to obtain opening London quotations at about 3:30 p.m., Singapore time, before the banks in Singapore close for the day. In Hong Kong, on the other hand, most banks are closed before the European money markets begin to open for the day's operations. The Singapore banks are also able to utilize an existing worldwide telex network in carrying out their operations.

The interest rates quoted by the licensed banks in Singapore for their dollar deposits tend to be about the same as those quoted in London for Euro-dollars, alghough on some occasions they appear to have been slightly higher. In mid-July of 1969, for example, the London rate for one-month dollar deposits was 10.25 per cent, while in Singapore, the Bank of America branch was bidding about 10.5 per cent.2/ In mid-April of 1970 the London rate for three-month deposits was 8.0 per cent while in Singapore the average rate offered by the licensed banks (the rates tend to vary from bank to bank) was 8.25 per cent for three-month deposits. By August of 1970, however, the rates were approximately the same, being 8-3/8's per cent for three-month deposits.

The licensed banks' lending rates for these funds, which are loaned to non-banks, reportedly range about 1.5 to 2.0 percentage points above the deposit rates, with a minimum differential of three-fourths of a percentage point. Hence in mid-July of 1969 the lending rate was roughly 12 per cent,3/ and in mid-April of 1970 it

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1/ Since Singapore does not have a central bank, statutory reserves are maintained by the commercial banks with the Office of the Accountant-General.
2/ "Far East: The Un-Asian Dollar," Euromoney, London, August, 1969, p. 30.
3/ Ibid., p. 30

was approximately 10 per cent. This compares with prime commercial bank loan rates of 8 to 9 per cent in Singapore and Hong Kong in those months.

Although the new market for Euro-dollars in Singapore got off to a somewhat slow start, a substantial number of banks have followed the lead of the Bank of America in obtaining government licenses to operate in the market. By April of 1970, or approximately fifteen months after the market's inception, twelve banks had obtained licenses to operate in the market.1/

Sources and Uses of Funds

The main suppliers of funds to the new market include individuals in Asian countries other than Singapore, commercial banks, foreign companies (especially international companies operating in Asia and overseas Japanese companies), official statutory bodies, and some central banks. Various reports indicate that American companies with major offices in Asia, and overseas Chinese with dollar holdings, have been important suppliers. Some funds have also been obtained from Indonesian banks.

No official statistics are available on the market, but an official of one of the licensed banks estimated in July of 1970 that deposits totaled about $200 million. This amount is, of course, very small in relation to the total of Euro-dollar deposits (excluding interbank redeposits) which was estimated by the Bank for International Settlements to be about $38 billion early in 1970.

The Singapore banks receiving these deposits are free to lend the funds directly to private or public borrowers anywhere in the world. Normally, however, banks licensed to deal in convertible currencies in Singapore would use these resources in large part to fund their branches elsewhere. The Bank of America, for example, could transfer surplus funds from its Singapore branch to its branches in Japan, Hong Kong, Korea, the Philippines, London, or to the head office in the United States. Various reports have indicated that the dollar funds mobilized by the licensed banks have been channeled mainly to the Euro-dollar market in Europe and to the United States, and most of the loans have carried maturities of less than one year. Since one of the objectives of the new facility is to mobilize Asian funds to meet Asian needs for medium-term investments, efforts have been made to find Asian borrowers, but so far only a relatively small

1/ These were: Bank of America, First National City Bank, Chase Manhattan Bank, Chartered Bank, Hongkong and Shanghai Banking Corp., General Bank of the Netherlands, Banque de L'Indochine, Oversea-Chinese Banking Corp., United Overseas Bank, Overseas Union Bank, Bank of Tokyo, and Mitsui Bank.

amount of development or working capital loans have been extended, mainly to Indonesia and Malaysia.1/ In order to avoid suffering losses on idle balances that carry a very high cost, the licensed banks have had to invest surplus funds in the Euro-dollar market in London. There is, of course, no profit for the banks in redepositing funds in the Euro-dollar market when they themselves pay rates equal to or higher than Euro-dollar rates, in order to obtain the deposits.

Expected Future Activity and Some Conclusions

The growth of the "Asian dollar" market has been limited by the relatively low demand in Asian countries for funds bearing Euro-dollar interest rates. The higher loan rates for dollar credits apparently caused the Asian demand for dollar loans during the market's first year of operation to be substantially below the supply of funds available. As a consequence, most of the dollar funds which have been mobilized have not actually been lent in Asia, but instead have found their way to Europe and the United States. This trend could conceivably change, however, if the interest rates charged by the licensed banks decline to more competitive levels.

Japan has been the only Asian country in the past decade that has borrowed substantial amounts of Euro-dollars, and the Japanese demand has subsided in recent years. In addition, the Bank of Japan recently imposed severe restrictions on foreign borrowing by Japanese banks, a step that will substantially curtail Japanese use of Euro-dollar type money in Japan.

There is a potential demand for dollar credits from other Asian countries, such as Australia, New Zealand, Taiwan and Korea. Conceivably these, and other Asian countries, might find it convenient to obtain these funds through the Singapore market rather than through London. The new Singapore market has both advantages and disadvantages. The advantages include a geographical location relatively close to the source of funds, and the fact that both Asian lenders and borrowers can deal with the Singapore banks during most of their regular working-hour day. Some of the main disadvantages are that lenders have to deposit their funds for a minimum period of

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1/ The Economist, London, March 14, 1970, p. 80; New York Times, New York, October 13, 1969, p. 71; Wall Street Journal, New York, December 29, 1969, pp. 1 and 24; and The Financial Times, London, August 18, 1970, p. 8.

one month (whereas deposits for as short a period as overnight are accepted in Europe), and that the loan rates for dollar credits have generally been higher than the rates for local currency loans to prime customers in some places in Asia.

Lately there has been a growing practice of financing imports, or projects, that require medium- or long-term financing, with short-term Euro-dollars. The interest rate for these loans varies, depending on the prevailing rate for Euro-dollars at the time that the loan is rolled over.

However, the Singapore market would have to expand greatly before it could readily provide financing for such big ticket items as a nuclear power plant or a half dozen jet aircraft. It is not clear where the funds in this volume would come from, but then it was certainly not clear in the mid-1960's that the Euro-dollar market could mobilize funds in the volume now available there. The funds are, of course, available, but what remains unclear is that there is sufficient advantage in doing business in Singapore to attract Euro-dollar business away from London.