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~~Confidential~~

The ECU banking market

After strong growth in the earlier years of this decade, the expansion of the reporting banks' ECU-denominated assets and liabilities slowed down markedly in 1986, and the share of ECU assets in banks' total non-dollar Euro-currency assets has since then remained stable at around 9%, although there have been renewed signs of dynamism and vitality more recently.

In mid-1988 the reporting banks' ECU assets amounted to ECU 95 billion. The bulk of this was booked with banks in Belgium-Luxembourg, France, the United Kingdom and Italy, with very little business elsewhere.

The ECU market is first and foremost an interbank market, with direct business with non-banks being relatively less important than in most other sectors of the Euro-market. For example, in mid-1988 interbank positions accounted for 77 and 89% respectively of the reporting banks' ECU assets and liabilities. Apart from supporting their ECU business with non-bank customers and their role as intermediaries in the ECU bond market, the banks use the ECU for arbitrage, funding and hedging operations. There is an active exchange market in ECUs, with spot and forward contracts and an efficient private clearing system with an estimated daily volume of ECU 15 billion.

The reporting banks' outstanding credits to non-bank entities amounted to ECU 22 billion in mid-1988, whereas deposit liabilities to non-banks totalled barely ECU 7 billion, or only 4% of overall non-dollar Euro-currency deposits. Given this very pronounced net creditor position, it would appear that the growth of the ECU market has been driven above all by borrowing demand. By far the most important borrowers were non-bank entities in Italy and France, where use of the ECU has been officially encouraged through its partial exemption from foreign exchange restrictions and by public sector borrowings in ECUs. In mid-1988 residents of these two countries accounted for over one-half of total ECU credits.

In more general terms, ECU borrowing may be attractive to entities from countries where domestic currency interest rates are higher than ECU rates, and at times when there seems to be relatively little danger of a depreciation of the domestic currency vis-à-vis the ECU. This helps to explain the buoyancy of the demand for ECU credits in the period up to 1985, when the strength of the Deutsche Mark within the EMS exchange rate band was mitigated by the unusually firm dollar. ECU borrowing may also be attractive for international firms with operations in several EEC member countries and for firms (such as Saint-Gobain) which have begun to use the ECU for their published accounts. Finally, ECU borrowing may to some extent be related to the role of the ECU as a unit of account in commercial transactions. Around 1% of France's and Italy's international trade is reported to have been invoiced in ECUs.

The relatively small amount of ECU-denominated non-bank deposits suggests that its attractiveness as a near-money substitute and store of liquidity is quite limited. In fact, since end-1985 ECU deposits have not, on balance, shown any growth at all. Moreover, the supply of ECU deposits is geographically highly concentrated, with nearly 45% of the total amount coming from residents of the Benelux countries. One important reason why non-bank ECU deposits grew much less than ECU credits was that, in contrast to ECU borrowing, depositing in ECUs was restrained by foreign exchange controls (e.g. in Italy and France) or other legal restrictions (Germany). However, these regulatory obstacles have now largely been removed, or are in the process of being removed.

On the positive side, a possible argument in favour of the ECU as

ECU 34 billion of ECU bonds outstanding in the international issue market. A substantial proportion of this paper is undoubtedly in the portfolios of non-bank holders.

One factor that may affect the demand for ECU assets, and possibly also ECU borrowing, is the forthcoming five-yearly review of the composition of the ECU basket in September 1989. Particularly if the Spanish peseta and the Portuguese escudo were to be included in the basket, this would tend to reduce the weight of the Deutsche Mark and the guilder in favour of currencies which bear higher interest yields and which tend to be more depreciation-prone in the eyes of the market. While the rules for changing the ECU weights require that on the day of adjustment the ECU's exchange rate shall not be affected, this provision obviously cannot safeguard the spot (discounted) value of longer-term ECU assets, unless the change in the basket weights has been fully anticipated by the market. This, however, will primarily affect the demand for ECU bonds. The demand for private ECU deposits, which are mainly short term, could only be affected shortly before the basket adjustment, and possibly afterwards if the market felt that the higher interest yield was no adequate compensation for the higher exchange risk involved. It should, moreover, be noted that the combined weight of the peseta and the escudo in the ECU basket would be unlikely to exceed 7%.

To sum up, following the vigorous growth in the first half of this decade the expansion of banks' ECU business has fallen back in line with the overall development of the non-dollar sector of the Euro-currency market. Whilst by no means negligible in absolute amounts, the banks' ECU operations with non-banks are still very small in relation to total Euro-currency business. In particular, ECU deposits have, on balance, shown no growth in recent years, despite the removal of a number of regulatory constraints. The ECUs used by the banks for lending purposes have, therefore, had to be created largely through the "bundling" or forward covering of the constituent currencies. Moreover, the geographical distribution of non-bank ECU borrowers and depositors remains highly skewed and some special incentives for ECU-denominated borrowing have fallen away as a result of the scrapping of exchange controls.

Despite a recent pickup of its rate of growth, the ECU market does not at present appear very likely to take over from the other sectors of the Euro-currency market and develop spontaneously into a major parallel

currency in the EEC member countries. For this purpose the geographical spread of borrowers and the non-bank deposit base in particular would have to be much broader. Greater use of the ECU in commercial transactions and also for payment and accounting purposes would undoubtedly help the further development of the market. Enhanced confidence in the stability of the EMS exchange rate structure would probably also be supportive, although this

Table II

The structure of the ECU banking market

(outstanding amounts in billions of ECUs)

	Assets							Liabilities						
	end-Dec. 1983	end-Dec. 1984	end-Dec. 1985	end-Dec. 1986	end-June 1987	end-Dec. 1987	end-June 1988	end-Dec 1983	end-Dec. 1984	end-Dec. 1985	end-Dec. 1986	end-June 1987	end-Dec. 1987	end-June 1988
Positions vis-à-vis non-banks														
domestic: EEC residents . . .	3.3	6.6	6.0	5.9	5.8	8.1	8.5	0.6	1.3	3.6	3.1	2.6	3.0	3.3
non-EEC residents	-	0.2	0.1	0.2	0.4	0.4	0.3	-	-	-	-	0.1	0.2	0.1
cross-border: EEC	1.0	2.9	4.9	5.7	5.9	6.7	8.0	0.4	0.9	2.1	1.7	1.8	2.0	1.9
other countries	0.1	0.6	1.4	2.3	2.7	2.9	2.5	0.2	0.5	1.1	1.0	1.0	1.2	1.2
unallocated	0.3	0.9	1.5	1.7	2.0	2.2	2.7	0.2	0.1	0.4	0.4	0.5	0.4	0.4
Total non-banks	**4.7**	**11.2**	**13.9**	**15.8**	**16.8**	**20.3**	**22.0**	**1.4**	**2.8**	**7.2**	**6.2**	**6.0**	**6.8**	**6.9**
Positions vis-à-vis banks														
domestic: EEC residents . . .	2.8	7.5	12.4	12.6	13.2	12.5	16.8	3.1	7.5	12.0	12.0	12.7	12.4	16.9
non-EEC residents	-	-	0.1	-	0.1	0.2	0.3	-	-	0.2	-	0.1	-	0.3
cross-border: EEC	6.1	18.4	28.6	29.8	30.2	32.7	37.5	6.8	18.6	29.0	31.4	32.0	33.8	39.2
other countries	0.4	1.4	3.7	6.6	7.0	9.2	10.4	0.5	1.9	5.1	7.3	8.1	10.9	12.8
unallocated	0.4	1.3	4.5	5.9	7.3	7.5	8.0	0.3	0.6	4.0	4.3	6.0	5.7	6.1
Total interbank*	**9.7**	**28.6**	**49.3**	**54.9**	**57.8**	**62.1**	**73.0**	**10.7**	**28.6**	**50.3**	**55.0**	**58.9**	**62.8**	**75.3**
Total	**14.4**	**39.8**	**63.2**	**70.7**	**74.6**	**82.4**	**95.0**	**12.1**	**31.4**	**54.5**	**61.2**	**64.9**	**69.6**	**82.2**

* Includes positions vis-à-vis monetary authorities.

Table III

The role of individual market centres in ECU banking operations

(outstanding amounts at end-June 1988, in billions of ECUs)

Banks		Belgium	Luxembourg	France	Germany	Italy	Netherlands	United Kingdom	Other EEC countries[1]	Total EEC	Other[2]	Grand total
ECU assets												
vis-à-vis	banks	14.0	6.6	17.9	1.5	8.8	2.5	17.5	1.5	70.3	2.7	73.0
	domestic	*2.7*	*2.5*	*5.3*	-	*1.5*	*0.2*	*4.4*	*0.3*	*16.9*	*0.2*	*17.1*
	cross-border	*11.3*	*4.1*	*12.6*	*1.5*	*7.3*	*2.3*	*13.1*	*1.2*	*53.4*	*2.5*	*55.9*
vis-à-vis	non-banks	4.1	2.5	4.9	1.2	2.8	0.8	3.7	0.9	20.9	1.1	22.0
	domestic	*0.3*	*0.3*	*3.0*	-	*2.8*	*0.1*	*1.1*	*0.9*	*8.5*	*0.3*	*8.8*
	cross-border	*3.8*	*2.2*	*1.9*	*1.2*	-	*0.7*	*2.6*	-	*12.4*	*0.8*	*13.2*
Total ECU assets		**18.1**	**9.1**	**22.8**	**2.7**	**11.6**	**3.3**	**21.2**	**2.4**	**91.2**	**3.8**	**95.0**
ECU liabilities												
vis-à-vis	banks	13.0	6.6	18.5	2.1	11.5	2.1	16.4	2.0	72.2	3.1	75.3
	domestic	*2.5*	*2.7*	*4.9*	*0.1*	*1.5*	*0.1*	*4.8*	*0.3*	*16.9*	*0.3*	*17.2*
	cross-border	*10.5*	*3.9*	*13.6*	*2.0*	*10.0*	*2.0*	*11.6*	*1.7*	*55.3*	*2.8*	*58.1*
vis-à-vis	non-banks	1.3	2.2	0.6	0.2	0.5	0.7	1.0	0.1	6.6	0.3	6.9
	domestic	*0.4*	*1.2*	*0.3*	-	*0.2*	*0.4*	*0.7*	*0.1*	*3.3*	*0.1*	*3.4*
	cross-border	*0.9*	*1.0*	*0.3*	*0.2*	*0.3*	*0.3*	*0.3*	-	*3.3*	*0.2*	*3.5*
Total ECU liabilities		**14.3**	**8.8**	**19.1**	**2.3**	**12.0**	**2.8**	**17.4**	**2.1**	**78.8**	**3.4**	**82.2**

[1] Denmark, Ireland and Spain.

[2] Austria, Finland, Japan, Sweden and Switzerland.

Table IV

Nationality of non-bank borrowers and depositors in the ECU banking market

(outstanding amounts in billions of ECUs)

	Borrowers							Depositors						
	end-Dec. 1983	end-Dec. 1984	end-Dec. 1985	end-Dec. 1986	end-June 1987	end-Dec. 1987	end-June 1988	end-Dec 1983	end-Dec. 1984	end-Dec. 1985	end-Dec. 1986	end-June 1987	end-Dec. 1987	end-June 1988
EEC*														
Belgium-Luxembourg	0.1	0.2	0.4	0.4	0.4	0.5	0.7	0.6	0.9	1.6	1.8	1.8	2.0	2.0
Denmark	-	-	0.1	0.3	0.4	0.4	0.4	-	-	-	-	-	-	-
France	1.0	2.0	2.4	2.2	2.2	4.2	3.9	0.1	0.2	0.3	0.3	0.3	0.4	0.4
Germany	-	-	-	-	-	-	-	-	0.1	0.6	0.3	0.2	0.3	0.3
Greece	-	0.1	0.1	0.2	0.2	0.2	0.2	-	-	-	-	-	-	-
Ireland	-	0.1	0.3	0.3	0.3	0.4	0.4	-	0.1	0.2	0.2	0.1	0.2	0.1
Italy	2.8	6.1	5.3	5.5	5.0	6.1	7.6	-	-	0.1	0.1	0.1	0.1	0.2
Netherlands	0.2	0.2	0.4	0.3	0.4	0.3	0.5	0.3	0.6	2.0	1.2	1.2	1.0	1.0
Portugal	-	0.1	0.4	0.6	0.5	0.5	0.5	-	-	-	-	-	-	-
Spain	-	0.4	0.8	0.7	0.6	0.7	1.0	-	-	-	-	-	-	-
United Kingdom	0.1	0.3	0.6	1.0	1.5	1.3	1.2	-	0.2	0.8	0.9	0.7	1.0	0.9
Total EEC	**4.3**	**9.5**	**10.9**	**11.6**	**11.7**	**14.8**	**16.5**	**1.0**	**2.2**	**5.7**	**4.8**	**4.4**	**5.0**	**5.2**
Other developed countries	-	0.3	0.6	1.1	1.3	1.4	1.2	-	0.1	0.5	0.4	0.4	0.6	0.6
Rest of the world	0.1	0.4	0.6	1.0	1.3	1.3	1.0	0.1	0.1	0.2	0.3	0.3	0.3	0.3
International institutions	-	0.1	0.3	0.4	0.5	0.6	0.6	0.1	0.3	0.4	0.3	0.4	0.5	0.4
Unallocated	0.3	0.9	1.5	1.7	2.0	2.2	2.7	0.2	0.1	0.4	0.4	0.5	0.4	0.4
Total non-banks	**4.7**	**11.2**	**13.9**	**15.8**	**16.8**	**20.3**	**22.0**	**1.4**	**2.8**	**7.2**	**6.2**	**6.0**	**6.8**	**6.9**

* Local and cross-border positions; due to rounding, individual figures may not add to totals.