Maturity Matching in the Euromarkets

Discussions of the stability of the international interbank market often overlook European and Japanese banks' borrowing in the international bond and note market. By relying less on short-term interbank deposits and more on intermediate-term obligations to fund their foreign-currency assets, these banks have made themselves more liquid and thus the interbank market more stable.

Not all international banks are depending more on the note market. Bank of England data on the balance sheet of British banks show no such trend. Data for Swiss, Canadian, and Italian banks are not available. But the French and Japanese banks have drawn on the international note market to reduce the disparity between their long-term lending and their long-term funding in foreign currency. This clearly emerges from the dollar balance sheets of banks in France and Japan as well as the nonsterling book of Japanese banks in Britain (chart). Although the dollar book of banks in Germany does not show such a development, in light of the activity of German banks in the international note market—Deutsche Bank alone raised over $1 billion there in 1982-83—their consolidated balance sheet probably shows the same trend.

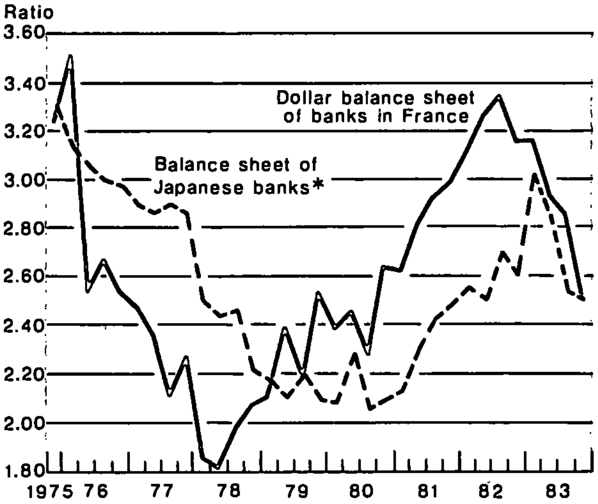
These banks are reducing the liquidity risk of heavy reliance on short-term funds by lining up funds in the range of 3 to 10 years. They are not necessarily betting on higher interest rates. This is because many notes that banks sell carry a floating interest rate, typically reset every six months in line with prevailing money-market rates. And even when banks sell fixed-rate obligations, they generally "swap" the proceeds with nonfinancial corporations for floating-rate funds.*

During the mid- to late-1970s European and Japanese banks did not have to go to the capital market to increase their liquidity. Instead they benefited from medium-term deposits made by OPEC countries that wished to diversify the nationality of the banks holding their assets. But two developments have since left these banks less liquid. First, as world petroleum markets weakened, oil-exporting countries slowed and then

*In a swap, a bank issues a fixed-rate note and a corporation obtains a floating-rate credit of similar maturity. Then, each undertakes to service the other's obligation. Such an arrangement is mutually advantageous when one or both parties is able to borrow relatively cheaply in the specific market it enters.

Maturity of the Foreign-Currency Balance Sheet of Selected Banks

Long-term assets to long-term liabilities



*Dollar balance sheet of banks in Japan, nonsterling balance sheet of Japanese banks in United Kingdom.

Sources: Bank of International Settlements, Statistics of Eurocurrency; Bank of England Quarterly Bulletin.

reversed their accumulation of foreign assets, especially medium-term Eurodeposits. Second, recent reschedulings of major international debts have lengthened the maturity of assets.

Although neither French nor Japanese bankers report any difficulty in raising short-term funds, they have indicated that officials in their countries have expressed concern about the banks' liquidity. Against this background, these banks began to close the gap between their long-term lending and their long-term funding in foreign currency. French banks started in mid-1982 after their change in management; Japanese banks started only after strains appeared in the international interbank market in the second half of 1982.

At the same time, developments in international capital markets have favored the banks' efforts to close the gap. Since 1982, banks have been able to sell fixed-rate obligations and convert the proceeds into floating-rate funds by swapping them with nonfinancial corporations. In this manner some banks secured three-month money over the medium term for less than they would pay for three-month money in the interbank market. Japanese and German banks have pursued these deals actively. French banks have not because official policy has reserved the fixed-rate sector of the international capital market for their domestic customers. In addition, the recent broadening and deepening of the Eurodollar floating-rate-note market has made it easier and cheaper for banks to raise medium-term funds there.

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