THE ECONOMICS OF THE EURO-MARKET

The Economics of the Euro-Market

History, Theory and Policy

R. B. Johnston

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Preface

This book is intended as a systematic treatment of the economics of the Euro-market. Its aim is to get to grips with the theory of this market and the policy implications. Several themes are developed: the evolutionary nature of the Euro-currency system, the integrated and competing relationship between Euro- and domestic money markets, and the need to look at the market in a segmented fashion to understand its overall significance. The reasons for Euro-market growth, the determination of Euro-currency interest rates and lending spreads and the market's macroeconomic implications are subjects examined in detail. The Euro-market is emphasised because of its role as a centre of international banking flows and because, in recent years, it has been the subject of international policy discussions. The importance of other international banking flows and their relationships with the Euro-market are also investigated.

As well as examining the theory, an attempt has been made to seek out evidence to test and illustrate the workings of the Euro-market. Emphasis is laid on practical aspects of the market's development and on an examination of relevant statistics. An amount of new research is included and econometric results are sometimes called upon when they help elucidate the discussion. There are, however, data problems, so that these results can only be indicative of the processes involved.

The examination of the Euro-market involves aspects of several branches of economics, and some knowledge of money and banking theory and international economics, though not essential, will be helpful. The main readership of this book will probably be advanced undergraduate or graduate students of international finance who wish to have a more detailed treatment of the economics of the Euro-market than is generally available in other texts. However, it is hoped that the book will also appeal to bankers and other practitioners in the Euro-market and that my fellow researchers and central bankers will find it of interest.

The book evolved from four years I spent working on international financial market questions with the Bank of England, and it was written while I was on secondment to the Bank for International Settlements in Basle. I am very grateful to the Bank of England for

allowing me to write it and to the Bank for International Settlements for accommodating me for a period of over one year while I worked on the drafts and for providing valuable technical assistance. I am especially indebted to D. G. Holland, Professor A. Lamfalussy, and C. W. McMahon for their support and for arranging that this could be possible.

I have learnt a great deal during my years with the Bank of England and this book has benefited greatly from my discussions with, and the work of, my colleagues and friends. Helmut Mayer provided a most stimulating input while I was at the Bank for International Settlements. Many of my colleagues also gave generously of their time and provided much-needed comments on earlier drafts. Clive Briault, John Ellis, Susan Howson and Jackie Whitley looked through several of the drafts and their comments helped me shape my thinking and stopped me going too far astray. David Holland made penetrating comments on a number of chapters, Charles Freeland kept me from making even more errors in Chapter 11, and John Bispham kindly read some of my more final versions. While I am very grateful to all these people and to all others who gave assistance, I have not always accepted their points of view and I am solely responsible for the final version. In particular, nothing that I have written should be taken to reflect the views of either the Bank of England or the Bank for International Settlements.

The job of typing the many drafts was undertaken by Rosie Munday and Julie Sowerbutts and supervised by Mlle. Conrad. They carried out what must have seemed an endless task with great speed, efficiency and cheerfulness and produced an excellent typescript. Frl. Capaul was responsible for much of the art work and Steve Arthur helped me look out data. I am grateful to all of them and to everyone else who made my stay in Basle such a valuable one.

Finally I would like thank Pat, my wife, for her encouragement and support towards the completion of this book.

May 1982

R. B. JOHNSTON