# EUROCURRENCY MARKET

# MEANING

- Used by banks, MNCs, mutual funds, hedge funds
- For circumventing regulatory requirements, tax laws, interest rate caps

# REASONS FOR RISE OF EUROCURRENCY MARKET

- Cold War between USA and USSR
- Petrodollars earned by Middle East countries during Oil Crisis (1974–1981)
- Regulation Q of Federal Reserve Act imposed ceiling on deposit interest rates
- Regulation M of Federal Reserve Act stipulated reserves against deposits
- Mandatory deposit insurance

# REASONS FOR RISE OF EUROCURRENCY MARKET

- Interest Equalisation Tax introduced by US monetary authority in 1963 increased cost of borrowing in US for nonresident entities.
- Voluntary Restraint Program in 1965 – borrowing in US for financing international projects was restricted. US MNCs were restricted from borrowing in US market.
- Foreign currency balance maintained abroad – no need for conversion, save conversion cost, exchange rate risk, earn higher deposit rates

# CHARACTERISTICS OF EUROCURRENCY MARKET

- Transactions are recorded abroad, but currency is held in country of issue
- Deposits and loans are outside regulatory and supervisory control of monitoring authority of country of origin
- Market for deposits and loans, borrowing and lending of currencies, not buying and selling
- Operates on interest rates, not forex rates
- Short-term deposits but medium to long term loans. This creates asset-liability mismatch, exposing Eurobanks to liquidity and interest rate risks.

# CHARACTERISTICS OF EUROCURRENCY MARKET

- Also called as Offshore market
- Dealing only in freely convertible currencies like USD, GBP, EUR, JP, CHF, CAD, AUD, etc.
- Wholesale market

# EURODEPOSITS

- Deposits are unsecured
- Short term – max. one year
- Standardised deposit amounts

# EUROLOANS

- Loans are medium to long term
- Interest rates are reset at fixed pre-decided intervals.
- Floating rate of interest – reference rate is LIBOR
- Interest rate = LIBOR + Markup
- Lending on consortium basis
- Unsecured
- Negotiated recovery
- Revolving credit
- Multiple currencies loan
- Drawdown schedule
- Pre-payment possible

# EUROBONDS

- Underwritten by multi-national syndicate of investment banks
- Issued in bearer form
- Pays annual coupons
- Convertible or non-convertible
- Sold in single currency in several countries
- No provision for early repayment of bonds, unless call option is provided
- Few protective covenants
- 70% of Eurobonds are denominated in US dollars
- Issued for 5-40 years

# TYPES OF EUROBONDS

- Straight Eurobonds
- Floating Rate Bonds
- Zero-coupon bonds
- Convertible bonds
- Sinking Fund Bonds
- Bonds with Options
- Collared Bonds
- Junk Bonds
- Deep Discount Bonds

# EURONOTES

- Issued by borrowers directly to investors without using bank as intermediary
- Note has shorter maturity than a bond
- Municipal securities – maturing in less than 1 year
- US Treasury note – 2 to 10 years (shorter is Treasury bill, longer is Treasury bond)
- Corporate notes – upto 10 or 12 years (short term are upto 5 years and long term are longer than five years)

# TYPES OF EURONOTES

- Commercial Paper – less than 1 year, excellent credit rating, lower than rate of banks, used to payoff expensive bank loans, promissory notes issued at discount, negotiable
- Note Issuance Facility (NIF) – Firm needs medium term funds but investors are short term – use of underwriters – notes are redeemed on maturity by issue of fresh notes – underwriter provides balance loan
- Medium Term Notes – medium term, fixed interest rate, no underwriting, 1–10 years, listed
- Bankers Acceptance – Importer get Bill of Exchange accepted by bank, assurance to supplier, importer gets better terms of trade
- Repurchase Obligations – Borrower sells securities to lender with commitment to repurchase at fixed future date – most secured form of lending

- UNSECURED BONDS AND NOTES ARE CALLED DEBENTURES

# FLOATING RATE NOTE (FRN)

- Coupon resets regularly
- Daily, montlhy, quarterly or annual resets
- Reference rate + Margin

# EXTERNAL COMMERCIAL BORROWINGS (ECB)

Bank loans

Securitised insruments

Buyer's credit

Supplier's credit

Minimum average maturity – 3 years