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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Asia-Dollar Market

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ER IM 70-74
June 1970

Copy No. 60

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1970

INTELLIGENCE MEMORANDUM

The Asia-Dollar Market

Introduction

In January 1969 an organized legal market in US dollars-known as the Asia-dollar market-opened in Singapore. This new overseas market in US dollars, while similar in concept, differs significantly from the Eurodollar market in origin, scope, and outlook.* This memorandum reviews the brief history of the Asia-dollar market and examines the unique characteristics that are likely to influence its future development. Black markets in US dollars operating in Southeast Asia are not discussed.

Background

1. In mid-1968, US bankers, with the cooperation of the Singapore government, quietly began drawing up blueprints for a miniature Asian version of the large and well-known Eurodollar market.** The bankers' principal objective is to mobilize large quantities of Asian-owned dollars for investment in Asia. The market's prime benefit to branch banks in Asia is that they would be less dependent on their head offices for loanable dollar

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*** Like Eurodollars, Asia-dollars basically are demand or time deposits denominated in US dollars that range in maturity from two-day call to one year. Only persons or institutions from outside of Singapore are authorized to make deposits in the Asia-dollar market, although residents of Singapore are permitted to borrow from it. New markets have also been created in Singapore for a few other hard currencies, including pounds sterling, deutschemarks, and Swiss francs. US dollars, however, account for about 95% of the total "Asia-currency" market.*

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

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funds. Bank of America inaugurated the Singapore-based "Asia-dollar" market at the beginning of 1969. Since that time, eleven additional banks have obtained licenses from the Singapore government to deal in Asia-dollars. Most of these dollar funds, which total only about $150 million, have been deposited with the three participating US banks: Bank of America, First National City Bank of New York, and Chase Manhattan Bank.

2. Eager to develop the Republic into Southeast Asia's leading financial center, the Singapore government became a willing partner in the Asia-dollar scheme. Its most important contribution to this goal was made on 20 August 1968, when it abolished the tax payable on interest on nonresidents' deposits to attract short-term foreign capital. Other countries in the area normally impose a tax of 10% to 40% on interest paid on deposits. Further in keeping with its ambitions, the Singapore government established a gold trading market in May 1969. [redacted] 25X1

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3. Several other considerations contribute to the suitability of Singapore as a home for the Asia-dollar market. This city has been the center of commercial activity in Southeast Asia since the middle of the 19th century, and its banking and insurance heritage is unrivaled in the area. Furthermore, Singapore is tied into a worldwide telex network, an advantage that has proved to be of great value for negotiating large volume and rapid international financial transactions. Banks in Singapore also have a decided advantage over banks elsewhere in Asia by maintaining the same hours of operation as those in London, thus strengthening the Asia-dollar link with the hub of Eurodollar market activity. The two most logical alternative locations for the Asia-dollar market—Hong Kong and Tokyo—are unsatisfactory because the former is unwilling to eliminate its taxes on interest and the latter is handicapped by burdensome exchange controls on capital transactions.

Structural Characteristics

4. Asia-dollar deposits and loans are characteristically much smaller than those in the Eurodollar market and, therefore, are more closely tailored to the local needs of Asian depositors and borrowers. Asia does not have the huge institutional investors or financiers that are commonly found in Europe. Consequently, Asia-dollar transactions will rarely be in the multimillion dollar range as is common in Europe. The $25,000 minimum deposit in the Asia-dollar market, for example, appears quite small in

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contrast to what is normally a $250,000 minimum for deposits in the Eurodollar market.

5. Official banking institutions represent the largest potential source of deposits in the Asia-dollar market. The Singapore government probably has supplied roughly one-half of the total funds presently in the market, but other governments in Asia have not contributed much to the market yet. As confidence in the Asia-dollar market grows, Asian governments are expected to switch some of the foreign exchange reserves they now have invested in the Eurodollar market to the closer Asia-dollar market. [redacted] 25X1
[redacted] approximately $3 billion of Asian official foreign 25X1
exchange reserves is now being held in the Eurodollar market. Some old animosities will probably prevent the potential for official sources being fully realized. For example, Malaysia has reserves of $600 million to $700 million invested in Europe which it flatly refuses to deposit in Singapore.

6. Commercial banks and international companies operating in Asia are also likely to be important suppliers of Asia-dollar deposits. The banks of Indonesia, which are now permitted by the government of Indonesia to place foreign currency deposits overseas, represent an important potential supply of funds for the market. Another major prospective source consists of the overseas Japanese companies which are increasingly being allowed by the Japanese government to invest their surplus dollars and other convertible currencies abroad. From time to time, non-Asian investors may be attracted to the Asia-dollar market because of the small minimum deposits required and the pledge by participating banks not to reveal the identities of deposits to anyone. Partly for this reason, the Commercial Bank of Czechoslovakia committed itself in 1969 to transfer up to $2 million to the Asia-dollar market.

7. One of the principal targets of the Singapore banks in their effort to attract more Asian-owned dollars to the Asia-dollar market is the Overseas Chinese community. Many of the more than 12 million Overseas Chinese (excluding those in Singapore) in Southeast Asia have amassed substantial fortunes in dollars through the large economic power they have wielded—especially in commercial sectors—in such countries as Malaysia, Cambodia, Indonesia, the Philippines, Thailand, and South Vietnam. Singapore, the only country in the world to be formed mainly by Overseas Chinese, has historically maintained a posture of close solidarity with other Chinese communities in Asia. In past years the largest source of foreign deposits in Singapore has been the Chinese population of Indonesia. More recently, the flow of funds into Singapore has come mainly from Hong Kong.

8. Few Asia-dollars have been loaned out in Asia thus far; rather most of them have been placed in the Eurodollar market. Others have been transferred from US bank branches in Singapore to their parent banks in the United States or other branches in Japan. US banks, however, remain convinced that a rapidly growing share of these deposits will be invested in Asia.

9. Prominent among the purported aims of the Asia-dollar market is the desire to provide a new source for medium-term development loans to support industrial growth in Asia. The Economic Commission for Asia and the Far East (ECAFE) discussed in general terms the possible role of the Asia-dollar market in financing regional development during its 25th plenary session in the spring of 1969. From the discussions emerged the hope that Asian-owned dollars can now be channeled to chronically capital-short Asian countries for development instead of winding up in Europe. Unlike the Eurodollar market, small firms are able to tap the resources of the Asia-dollar market. Loans as small as $50,000-often not large enough to interest European bankers-are not unusual in the Asia-dollar market. Because of the higher risk factors on loans in the Asian area and the practice of using short-term deposits to extend medium-term development loans (as well as the greater costs entailed in the smaller amounts of funds changing hands in the Asia-dollar market), the spreads between the rates of interest chargeable on loans and the rates paid on deposits in the Asia-dollar market are appreciably greater than comparable spreads in the Eurodollar market.

10. It is too early to predict whether Asiadollars will in fact be used for development purposes to any great extent. There have been few Asia-dollar loans extended for this purpose yet, with the exceptions of several small projects in Indonesia and Malaysia. Projects in Singapore, Australia, and New Zealand are likely to be the most attractive candidates for Asia-dollar loans in the future because of the relatively stable economic and political prospects for these countries. Both Japan and South Korea probably will continue to take all the Asia-dollars they can get. US international corporations could well become the best customers for Asia-dollars in the area. They are known for their resourcefulness in raising large sums of capital overseas for local projects. However, Asia-dollar borrowers, regardless of nationality, will undoubtedly acquire substantial funds for non-development purposes, such as working capital.

11. The investment demand for Asia-dollars in Asia has been unexpectedly weak during the market's first year of operation because of the

prevailing high interest rates for Asia-dollar loans, which usually have exceeded 10%. Local currency loans often could be obtained in Asian countries, mainly through development agencies, at rates of interest well below this. Although some demand for convertible currencies exists despite high interest rates, the generally deficient demand for these funds in Asia has been largely responsible for the exodus of Asian dollars to the Eurodollar market or to parent banks in the United States.*

Conclusions

12. Based on the favorable reaction of a number of major banks in Singapore to its creation, the now minuscule Asia-dollar market seems likely to experience significant expansion in the next few years. Its long-run potential, however, is not likely even to approach that of the present Eurodollar market with its mammoth resources, wealth of financial experience, and vast array of sophisticated banking institutions. Moreover, the exchange controls that exist in various Asian countries will continue to inhibit Asia-dollar growth. However, as more potential depositors learn of the market and gain confidence in it, the Asia-dollar fund, which has grown only grudgingly over the initial 15 months of the market's lifespan, could expand within two or three years to $1 billion or $2 billion.

13. Asian governments will probably be the mainstays of the market over the next few years. US foreign aid receipts and expenditures by US military forces will continue to boost the official dollar reserves in East and Southeast Asia. If the market demonstrates an impressive growth performance, Japan is likely to emerge as the major supplier of dollars to the market.

14. The more immediate problem facing the Asia-dollar market is not so much one of supply as of demand. Asia-dollar bankers claim that they now have plenty of money, but they cannot find enough interested borrowers in the area to utilize it. As credit eventually eases and attendant high interest rates fall in the Eurodollar and Asia-dollar markets, however, the local demand for Asia-dollars could well match and perhaps surpass the supply.

** Interest rates on Asia-dollar deposits are usually pegged slightly below those of the London-based Eurodollar market. Singapore bankers of course will not pay steep rates for deposits unless they can lend immediately at a still higher rate. Consequently, with the soft demand in Asia, most of the Asia-dollars have either been quickly transferred to the Eurodollar market or to home offices to augment working balances.*

When this happens, the flow of dollar funds from Asia to Europe and the United States would probably be reversed. The liquidity capabilities of banks to finance medium-term development loans with short-term deposits are uncertain at this time. The consensus among bankers in Asia is that the next year or two could be critical for the success of the Asia-dollar concept. If the scheme succeeds well in Singapore, there is a strong possibility that it may be applied in other parts of Asia, and most likely in Tokyo.