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Banking War Breaks Out Over Euro-Market Breakdown

BANKING

West German, British, and U.S. regional banks have recently taken drastic measures to insulate themselves from a threatened breakdown of the immense Eurodollar loan market — a breakdown which could ultimately send Chase Manhattan, Bankers Trust and the other dangerously over-extended, giant New York commercial banks to the bankruptcy courts. According to a high-level West German political source, "there will be a small crash, not a big crash" on the Eurodollar market, a statement which indicates that West German banks believe they, at least, will emerge relatively unscathed from the crisis while Chase and the other New York majors are forced to "take a bath."

In a major article entitled "IBEC to Issue Red Dollar?", the Italian newspaper Il Sole this week warned of a "general illiquidity crisis" which is prompting leading City of London bankers, among others, to favor use of the Comecon transfer-ruble as an alternative international reserve currency to the U.S. dollar. Il Sole was referring to the over $450 billion in "problem" Third World and European debt overhanging international markets, of which U.S. banks hold the principal share. Following Morgan Guaranty's public admission that the "private sector" could no longer handle the refinancing of this debt, C. Fred Bergsten, Carter's Treasury Under-Secretary for International Affairs, last week called for a beefing up of U.S. and other nations' contributions to the International Monetary Fund in 1977 to stave off the crisis. But with the West German government's known opposition to any reflationary measures, seasoned financial observers are giving this latest Carter monetary initiative "a snowball's chance in hell"—and the stage is set for a major Euro-market crunch.

Regionals Bail Out of International Syndications

The biggest trouble-spot is the large Eurodollar syndication loans to Third World countries, many of which are already in default. The syndication loans originated in the first place as a means by which U.S. regional banks could be lured into taking on joint loans with the international banks, thereby "sharing the risks" and ensuring that Chase et al. would not have to put all their eggs in one basket. According to informed sources, the regionals are pulling out now while they still can and are liquidating their share of the bad syndicated loans at 8 cents to the dollar; the "going" rate was previously 25 to 30 cents. In many cases, regional banks have forced the syndicate leader, generally Chase, Citibank, or one of the other major international banks, to buy back the regional bank's share of the bad paper in order to avoid an embarrassing lawsuit. (The recent lawsuit against European-American Bank for its role in organizing loans to the bankrupt Colocotronis shipping firm is mild compared to what Chase is threatened with.) New loan syndications have virtually ground to a halt, and the New York commercial banks' overexposed position has been substantially increased just at the point when a new round of defaults is threatened.

The Bank of England, meanwhile, appears to be providing an extraordinary "safety-net" for British banks to cover them in the event that financial troubles overtake New York. According to money market experts, the Bank of England had funneled $2 billion in "hot money," which flowed into Britain during January, back onto the Eurodollar markets through the British banks, despite the fact that this is in violation of standing Group of Ten agreements. Normally, City of London institutions depend for their profits on short-term interbank loans from New York which they then re-lend long-term on the Eurodollar markets. Should the New York commercial banks be forced to call in their loans to London, British banks would immediately be implicated in New York's crisis, a situation which the Bank of England action may be intended to avoid.

Eurobond Market Takeover

European banks have been taking over the more viable Euro-currency market investment opportunities, such as the Eurobond market — representing loans to mainly European governments and the better-off U.S., Canadian, and European corporations. *Business Week* reported in January that West German and Swiss commercial banks now control the Eurobond market, which was formerly dominated by U.S. and British commercial and investment banks. The extent of their success is indicated by the fact that Mobil Oil had to go to Union Bank of Switzerland for its latest Eurobond flotation, when its traditional banker is Morgan Stanley. Superior bond retailing capabilities are not the West German-Swiss banks' only advantages; they have consistently offered easier terms to, in particular, French and Scandinavian borrowers, indicating a broader political commitment to keep West Germany's principal trading partners afloat.

While the New York banks have recently curtailed their lending to the Soviet Union and Eastern European countries due to alleged "national security" con-

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siderations, the West German Dresdner Bank is enthusiastically expanding its loans to the Comecon sector. A Dresdner Bank-led consortium last week announced a $600 million loan to Comecon's International Investment Bank, just two weeks after U.S. banks had "put on ice" a $200 million loan to another Comecon institution, the International Bank for Economic Cooperation (IBEC).

Increasingly shut-off from still available profit-making investment outlets in the Western European and East Bloc sectors, the New York commercial banks have only their defaulted Third World paper to fall back on. "The New York banks are overlent," scoffed one West German banker this week. "They have no power left on the Eurodollar market, and they should shut their mouths. We are fed up with them."

U.S. Regionals Retaliate

An SEC investigation of charges that the New York commercial banks secretly dumped New York City securities in anticipation of the fall 1975 crisis may provide U.S. regional banks the ammunition with which to destroy New York's power. According to an SEC official, the New York banks unloaded $2.7 billion worth of city securities during the first quarter of 1975. Regional banks—oblivious of the city's cash-shortage—bought up $6.9 billion worth of these securities in the second quarter.

The Rosenthal House subcommittee's investigations represent a different factional interest, however. Basing himself on the recent GAO audit report on government regulatory authorities, Rosenthal announced this week that the 30 largest U.S. banks hold $80 billion in foreign loans, $11 billion of which are in danger. Although these figures are in themselves gross underestimates, Rosenthal committee aides later attempted to reassure inquiring callers by stating that the $11 billion represents merely loans "criticized" by bank examiners and which are not necessarily "bad." "I hope no one sells their bank stocks over this report," cautioned one committee staffer. The Rosenthal-GAO investigations are actually efforts to *manage* the New York banks' crisis, by imposing top-down corporatist control over the nation's banking system, a goal which is supposed to be achieved through the collapsing of existing regulatory authorities into one super-agency and the destruction of the independent powers of the regional Federal Reserve Banks.

European Bloc To Protect Snake; Move To Gold System Next?

FOREIGN EXCHANGE

An uneasy equilibrium prevailed in the foreign exchange markets at week's end, with traders projecting a slight further weakening of the dollar in coming days due to the ongoing impact of the weather and the Carter Administration's contractive energy-supply policies.

The major development of the week, however, occurred not in the U.S. but in Western Europe, where, in a climate of public discussion of the remonetization of gold and the international use of the transferable ruble, the Feb. 14 meeting of central bank governors and finance ministers officially rebuffed efforts by Carter advisors and the Federal Reserve to force a revaluation of the mark and yen, along with a stringent weakening of the "lower-tier" currencies. These currencies, instead of sinking in the side-pull of a drop in the pound, strengthened against the dollar as Europe affirmed its determination to maintain internal and external parities.

U.S. authorities' preoccupation with pushing down the "lower-tier" currencies was oddly underlined the previous week when Lawrence Klein, a Wharton School economist serving as Presidential advisor, followed his Feb. 9 call to Congress—for a 10 per cent upward revaluation of the yen and mark against the dollar — with a Feb. 11 statement that he had really meant to say the mark, yen *and* dollar should all appreciate against other major currencies.

In between, the central bankers of both Japan and West Germany had coolly rejected Klein's first call, which amounted to an Administration attempt to prediscount the corrosive effects on the dollar of Federal Reserve money-creation to facilitate international debt refinancing. This unilateral printing-press policy, specified repeatedly in recent days by Treasury Undersecretary C. Fred Bergsten, has thus far barely aggravated market edginess about U.S. inflation, but its longer-term implications for dollar stability are plain to European authorities.

At the conclusion of the Feb. 14 Brussels meeting, Bundesbank deputy director Otmar Emminger reiterated the view that Klein's demands were out of spirit with the fight to stabilize the internal parities of the jointly floating "snake" currencies as well as the pound, and their respective crossrates with the dollar.

The bitter experience of 1976, said Emminger, shows that the revaluations and devaluations have nothing to do with economic recovery. His statement was echoed by West German Finance Minister Hans Apel, a close collaborator of Chancellor Helmut Schmidt, and by Belgian Finance Minister Willy LeClerc.

Reversals

The same day, a short-selling run against the pound