

Eurodollar Lending Spree Entraps U.S. Commercial Banks

Preliminary reports from Wall Street banking analysts indicate that the major U.S.-based international banks have embarked on a fourth quarter foreign lending expansion which could leave them dangerously exposed in the event of a market shakeout. As the EIR previously reported, the accumulation of excess dollars abroad in the so-called Eurodollar market has led to rampant competition among international banks during 1977, and a resultant shrinking in the margins which banks earn on Eurodollar loans. Not only are bank margins continuing to fall, analysts say, but banks are attempting to make up for their reduced earnings through an ever-increasing volume of loans.

Banking

A new OECD quarterly publication called "*Financial Market Trends*" has forecast stepped-up Euromarket lending in the fourth quarter. The OECD noted that at the beginning of October, \$6.25 billion in medium-term Eurocredits were under negotiation compared to \$4.5 to \$5 billion in previous months. As of the end of the third quarter, the OECD estimated, publicized medium-term Eurocredits had already been expanding at a \$30 billion annual rate, or 20 percent over the 1976 level.

While the OECD indicated that heavily indebted Third World and Eastern European borrowers would require major refinancing, the collapse of the U.S. dollar has added a vicious new twist to the fourth quarter scenario. Such unlikely borrowers as Malawi and Madagascar are reportedly lining up large Eurodollar credits which are then immediately converted into "hard" currencies, such as the deutschemark, Swiss franc, or yen, so as to speculate on the dollar's further decline. Paraguay, for example, recently received a \$120 million loan for a "development project" probably requiring only about \$10 million. The remaining funds will likely be redeposited on the Eurodollar markets where they can be easily mobilized into currency speculation.

A new feature adding to the chaos on international currency markets is the growing role of British merchant banks, acting in advisory capacity to Third World central banks. A feature in the Oct. 27 issue of the *Economist's* "Financial Report" newsletter reveals that some of the British advisors, led by Schroeders and N.M. Rothschilds, have displaced the New York Fed and the leading New York commercial banks as placers of surplus reserve funds of the central banks of the Third

World. Schroeder offers a "Reserve Asset Management Plan," Rothschilds offers Rothschilds Asset Management, and other merchant banks provide similar services.

A particularly nasty feature of the operation, according to the newsletter, is that Schroeders have pioneered "Operations Research" techniques to search for best-return possibilities on the international markets — putting at least part of central bank capital flows onto a computer loop! EIR's information is that British advice pushed a lot of central bank money out of the dollar. In addition, the "advisors" have encouraged Third World central banks to borrow all they can now and use the funds to buy deutschemarks and Swiss francs, to be repaid in depreciation dollars.

Pulling the Plug

Although the banks may be making a few "quick bucks" on such operations, what would happen if someone were to inadvertently "pull the plug"? Conservative business opinion in the U.S., centered around Federal Reserve chairman Arthur Burns, is currently leaning toward an "icewater" solution for the dollar crisis — a sudden, chilling "bath" of high interest rates to halt the excessive money supply expansion. If this should happen, the present "excess liquidity" conditions on the Euromarket could turn into a serious money "drought", especially since U.S. corporate short-term credit needs are already beginning to rise. Bank refinancing of Third World debt might then become nearly impossible.

Business Week's lead article in its Nov. 7 issue "The Glory Days Are Over at Citicorp" (which undoubtedly evoked hearty chuckles among London merchant banking circles) gives some indication of the New York banks' dilemma: "The banks, the argument goes, are in so deep in LDC debt that there may be no way out except to lend more money to be used to repay existing debts. According to economists at Amex Bank Ltd., a London affiliate of American Express Co., one out of every two dollars borrowed by developing countries in the Eurodollar market in 1980 will be used to repay debt. By 1985 two out of three of those Eurodollars will go for debt."

The article also cites Morgan Guaranty estimates that non-oil producing developing countries will have to repay \$24 billion in principal and interest this year, \$29 billion next year, and \$33 billion in 1980.

Citicorp is particularly vulnerable to LDC defaults, since, as of year end 1976, the bank held \$9.1 billion in loans to LDC's — the largest exposure of any U.S. bank —

and has drawn 30 percent of its earnings from such loans. Although Citicorp officials argue somewhat plausibly that their loans are of "high quality" relative to some other banks, the risks are undeniable.

As one bank analyst remarked: "Unless world trade picks up, both in the LDC's and especially the OECD countries, the New York banks can't go anywhere. Increasing retail trade won't work. It will just mean trying to take the business away from regional banks, and the regionals are better suited to hold onto their customers."

What *Business Week* failed to mention, however, is the composition of Citibank's foreign loan portfolio. Fifty percent of all Citibank foreign loans are denominated in foreign currencies, and a much greater portion are lent to relatively viable corporate or government entities within the borrowing countries, rather than to the government or central bank of the borrowing country itself. This compares to a figure of about 20 percent for Chase Manhattan, or 40 percent for Bank of America.

Unlike Chase, Citibank has entrenched its operations within the internal economies of borrowing countries. The risk of its portfolio is therefore associated to a greater extent than other banks with the ultimate viability of LDC economies than their near-term balance of payments status. Citibank officials also assert that their lending is strictly geared towards income-earnings projects rather than general balance of payments needs. There is no way to document the assertion, but the currency-composition of its foreign portfolio suggests there is some truth to it. Speaking privately, one banking official qualified the *Business Week* report as "the kind of garbage that ought to be handed out on street corners, not printed in a respectable publication."

The French employers' association publication *Energies* went to the heart of the matter. Citing an hitherto unknown "White House study", *Energies* stated that in the event of Third World defaults a major banking crisis could hit literally "overnight", leading to a run on

U.S. banks. The only solution would then lie in a new "tripolar system (in which) the Western nations define a policy of cooperation with the Third World as they recently did with the East."

Triaging the "Brazils"

So far this year, Citicorp and other New York banks have attempted to cut back on their lending to those Third World countries which already have high debt ratios. Brazil, for example, with \$30 billion in foreign debt, has been told that it cannot get medium-term loans for less than 2 percent over LIBOR (the London Interbank Overnight Rate) even though India recently received a Euroloan at 1 percent. Morgan's figures show that medium-term syndications for the non-OPEC LDC's as a whole have risen only 10 percent during 1977 compared to 20 percent for the market as a whole.

Nevertheless, the squeezing out of the "Brazils" cannot go on indefinitely. Although Brazil's reserves were buoyed this year by the run-up in coffee prices, wholesale coffee prices have now collapsed. Following weeks of effort to "bull" the market by withholding coffee from the market, Brazil finally relented and sold 150,000 bags at \$1.70 per pound, 45 percent off its "official" export price. Ironically, Brazil's sale came just as other coffee producers were close to agreement on Brazil's high-price strategy. According to *Business Week*, the Brazilian government's haste to sell came as "shocked" authorities discovered that the country had run a cumulative trade deficit of \$50 million through August, rather than the expected \$250 million surplus. Brazil must add \$500 million to \$600 million to its 1977 coffee exports to "avoid finishing the year with a sizeable trade deficit."

Brazil will likely require hefty refinancing by early 1978, and if the funds are not forthcoming, even "respectable" Brazil could be forced into default.

Soviets Equivocate On T-Ruble

In a speech delivered at the Oct. 16-20 Budapest "Workshop on East-West European Economic Interaction," National Bank of Hungary Deputy Chairman Janos Fekete discarded the feasibility of a gold-pegged transfer ruble system as the basis for hard-currency credit issuance. Although the declaration represents a spectacular setback from Fekete's own previous terms, it does not mean that the transfer ruble option has been dropped by the Soviet sector. On the contrary, there are signs showing that the "t-ruble" alternative is still alive east of the river Oder, and backed by banking and industrial forces in France and West Germany.

Crass Stupidity

The Fekete speech is significant for three reasons. First, Fekete had been until now a leading proponent of the transfer-ruble system, and his statements usually reflect the thinking of the dominant economic and

political faction within Eastern Europe's Council for Mutual Economic Assistance (CMEA). Second, the speech was delivered to an East-West audience on a problem seldom tackled by East bloc spokesmen in official conferences. Third, the speech comes at a decisive juncture in the world strategic situation and was purposely intended to be published at this point; it was written on Aug. 31 and kept confidential until the Budapest conference.

On those grounds, and keeping in mind that Fekete is no freshman in international finances, his speech can only be characterized as crass stupidity concerning the objective interests of the East bloc and the world economy. Fekete's line amounts to endorsing the proposals of Italian Central Bank official and City of London agent Giovanni Magnifico, originally peddled last summer at the Siena group's meeting of economists, a monetarist swamp used for the flotation of