Banking by Kathy Burdman

Where are the weak links?

Continuing problems for the biggest U.S. institutions on the interbank market could produce a crisis at any moment.

Several of the largest American banks have been excluded, to one extent or another, from normal funding operations during the past four weeks, the first time any development of this sort has occurred, including the worst of the last Great Depression (named the way 1914-18 was called the "Great War"). These include:

Continental Illinois of Chicago, excluded from the "no-name group" of large commercial banks who pool their funding operations in the Certificates of Deposit market, following the failure of the Penn Square Bank in June;

Manufacturers Hanover Trust, also excluded from the "no-name group" of commercial banks, ostensibly because MHT published the fact that its Mexican exposure was $1.4 billion at the point Mexico went into de facto debt moratorium. As the *Journal of Commerce* pointed out in an Aug. 27 editorial entitled, "The Mexico Witchhunt," MHT hardly deserves singling out, since the exposure of both Citibank and Bank of America in Mexico is twice as large, although not published; but some market operators may know additional compromising facts concerning Manny Hanny.

Chase Manhattan Bank, in a well-publicized embarrassment, had difficulties marketing its own CDs following the Lombard-Wall Securities failure, which cost Chase $40 million; Chase had already lost close to half a billion dollars in the earlier failures of Drysdale Securities and Penn Square Bank.

Bank of America and other West Coast banks were temporarily unable to market Certificates of Deposit when Mexico announced it had run out of cash, an extraordinary development, considering that the Bank of America is the country's largest commercial bank.

Although the initial Mexican shock dissipated, to some extent, after the Bank for International Settlements poured $1.85 billion of pooled central-bank money into Mexico's creditors, and the huge spread between Treasury bill and certificate of deposit rates narrowed somewhat upon announcement of the bailout, the situation could go sour at any moment.

Virtually any adverse news, e.g., the report Aug. 26 that the Nederlandsche Credietbank, 32 percent owned by Chase Manhattan, had closed 40 of its branches due to financial problems, prompted a new movement into ultra-safe Treasury bills out of bank CDs, at the point when the Mexican issue appeared to have quieted.

The next bad news will probably hit from the interbank market. After the November 1979 American freeze of Iranian assets, Arab depositors put over $100 billion of new funds into European and Japanese banks, mainly Japanese banks, rather than into American banks.

As the American banks commented at the time, the U.S. institutions reborrowed these funds on the interbank market, the $800 billion exchange of deposits among Eurodollar banks. The full amount of American indebtedness on the interbank market is not known, but it may run into the scores of billions.

The *Financial Times* of London's Banking editor, William Hall, warned Aug. 26 that Japanese or other banks may, "on orders from their superiors," attempt to call in their deposits from American banks, the quality of whose assets is suspect among international banks. Japanese banking sources confirm that orders have already gone out to reduce exposure to American banks, although they rule out any sudden action that could backfire against them.

"Although we want to reduce exposure," said one Japanese bank economist, "we must remember that Japanese banks also have $10 billion in loans out to Mexico."

American banks, in turn, are making substantial arbitrage profits lending to other national banking groups who borrow from U.S. institutions through the interbank market.

U.S. banks will offer bank commercial paper in the U.S. and lend the proceeds to foreign banks at a spread that used to stay below one-half percent, but now might be as high as 1½ percent or more. Following the failure of Banco Ambrosiano of Luxembourg, which stiffed its banking creditors for more than $400 million, second-tier banks in the international markets have difficulty obtaining funds.

The American banks are, momentarily, making good money by using their own credit rating to fund the second-tier banks.

"There are limits past which this cannot continue," said a Federal Reserve official responsible for monitoring banks' problems. "We have not reached those limits yet, but we are monitoring the situation on a daily basis."

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