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The banking crisis is out of control

by David Goldman

At 7:50 a.m. EST Thursday, May 24, *EIR* European Economics Editor Laurent Murawiec filed a report that Manufacturers Hanover Trust paper in London had fallen to a deep discount and that the bank had significant funding problems. MHT took the worst hit because it has triple its capital in Brazil alone, and the big European banks are responding to last weekend's declaration of an Ibero-American debtors' cartel. The Dow-Jones newswire broke a story at 11:27 a.m. the same day reporting rumors to this effect, which *EIR* had already confirmed. Thursday's panic against bank stocks then ensued.

An *EIR* Alert Bulletin of March 16 had already reported Manufacturers Hanover's problems:

"If a portion of Argentina's $45 billion foreign debt is declared non-performing on March 31 as threatened last week by Manufacturers Hanover President Harry Taylor, 'Manufacturers Hanover may have to be merged to avoid further trouble,' a top accountant at one of New York's Big Eight accounting firms told *EIR* today. The source said he had heard this 'several times now from very high-level people. I'm beginning to be worried.'

"The Federal Reserve's plan, if a run does develop on Manny Hanny deposits or stock, would be to merge Manufacturers Hanover and another large New York bank 'which would be experiencing similar troubles' by that time, the accountant stated. 'That way they could consolidate the debt and only have to deal with one bailout situation.'"

Now general monetary warfare has begun against the United States, along the battle lines *EIR* described first in 1983 and continuously during the past several months. The United States, a net debtor nation for the first time since World War I, is now subject to depredations of European creditors. These propose to do the same thing to the United States that the Reagan administration has sanctioned in the case of the big Third World debtors: to use the leverage of a shutoff of credit to dictate domestic policy, as well as contracting credit to dictate defense policy, to the United States.

That they mean to dictate domestic policy was made explicit by the chairman of the Bank for International Settlements, the command-center for such monetary warfare, Fritz Leutwiler of Switzerland. Speaking at a Swiss seminar just after Continental Illinois fell, Leutwiler warned that countries that engage in excessive foreign borrowing—referencing the United States—"are merely postponing the fight among their citizens for the distribution of limited resources."

Friday's markets calmed only because major banks bought their own Certificates of Deposit (CDs) off the trading floor to avoid steep reductions in the value of their paper. This is the rough equivalent of a corporation borrowing from loan sharks in order to prop up the value of its stock on the market.

The banking crisis is fully out of the Federal Reserve's control. To the extent that the Fed does what New York Federal Reserve President Anthony Solomon swore to do Thursday night, i.e., "stand by the banking system," it will produce an irrevocable crash of the dollar and collapse of the U.S. economy through excessive use of the Treasury printing presses.

The dollar's steep drop on the foreign exchange markets on the afternoon of May 24 gave a foretaste of what will happen if the Federal Reserve chooses this course.

Contraction of the Eurodollar market

On May 23, the London *Times* stated bluntly the reasons for Manufacturers Hanover's predicament: "Banks fear debtors' cartel over $340 billion Latin [American] loans." The lead article of the paper's economic section, datelined Washington, reported: "Fears were growing among international bankers in Washington last night that Latin America is about to form a 'debtors' cartel.'"

The report continued to cite last week-end's joint com-

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muniqué of four Ibero-American heads of state as "a signal [of] a new confrontation over repayments. . . . Some bankers fear that Argentina, which had earlier refused to meet scheduled loan repayments, is pressing other debtor nations to take similar action to increase the region's bargaining power with international banks."

The *Times* article mentions generalized rioting throughout the continent, the recent additions to the debt burden due to increased U.S. interest rates, and the call issued by Ibero-American leaders for an emergency debtors' summit meeting. "Although the tone of the communiqué was moderate, it nevertheless marks the first time Latin American nations have banded together to seek better terms."

In France, the daily *Le Matin* reported May 25 on the May 19 meeting of the Latin American Association of Development Finance Institutions (ALIDE), and its recommendations that there be "a joint renegotiation of debt," rather than a case-by-case situation that might lead nations to "unilaterally decree moratoria"—"a clear threat on their part," commented the French daily.

Le Monde, which gets its financial briefings from Lazard Frères of Paris, wrote in an editorial on May 23: "Latin America rebels. The impossibility to repay the debt is not doubted any more by anyone. In such circumstances, the appeal issued by moderate and reasonable heads of state might be the last chance before the establishment of a debtors' front that will wield the very real threat, this time around, of stopping all payments."

A London banker stated one day before the panic began: "A 5% contraction of the Eurodollar market might well be underway as a result of the Continental Illinois crisis, and with an interbank market of $1 trillion on the Eurodollar market, that means well over $50 billion that evaporated in ten days." According to a Frankfurt banker: "Banks are cutting their internally-fixed lending limits to American banks; they are cutting down on the credit lines and other exposure to American banks—especially the smaller ones, since the Fed will bail out the huge ones—and U.S. banks cannot even get a rating in London; they could not sell a toothbrush with their name on it." Other sources note that there is simply no historical precedent for U.S. banks being unable to place their paper. In effect they have been quarantined by the rest of the world banking community.

The largest U.S. banks, as a result, are themselves calling in their loans to smaller banks in order to strengthen their own liquidity position, which is badly maimed by runs on deposits, an ongoing collapse of their share value, and the adamant refusal of non-American banks to buy U.S. bank paper unless punitive interest rates are paid to secure it.

Bringing down Reagan

A well-placed Geneva banker reported on May 25 the following evaluation of the political consequences of the Continental Illinois crisis: "Credit is going to be massively contracted, world-wide and of course in the U.S.A. Volcker is preparing Reagan's non-reelection. He's preparing a super-squeeze. Ronald Reagan and this idiot Don Regan are totally unaware of what's going on. They're going to move on until they get badly bashed over the head. The European recovery is already vanishing; it's something of the past. Projections for economic growth are already beginning to be revised downwards. And the pressure of the Latin American heads of state won't work—the White House is the hostage of the banks. So, the game is going to blow. Next, everything depends on Volcker: If he monetizes the American banks' bad loans, it will drown the problem in an ocean of liquidity. If he does not, well, the only thing the White House could do is bump off Volcker. But then, the Democrats are protecting Volcker: He's doing their job, destroying Reagan's recovery. And this poor Reagan does not see the danger."

According to a London *Financial Times* guest writer May 23, New York money manager George Soros, who is close to the Morgan, Stanley investment house, the United States should drastically cut military spending in order to save the world from the debt crisis. Entitled "International debt—the danger of Reagan's imperial circle," the article explained that "the Reagan administration has developed a new form of economic imperialism which allows it to finance a high budget deficit at the expense of the debtor nations. The policy is likely to appeal to voters, but will have disastrous consequences."

Banks get in deeper

Friday's market quieted due to massive intervention by the banks themselves (the Federal Reserve not yet in evidence) to buy up their own CDs through intermediaries, in order to avoid the embarassment of steep discounts or even a stoppage of trading. Rumors circulated wildly, e.g., that CDs of Chase, Manufacturers Hanover, and Continental Illinois were not trading at major brokerage houses. CDs were not trading because the banks snapped them up off the market. To do this, they borrowed heavily on the Eurodollar market, pushing the six-month Eurodollar rate up by 3/16% on both May 24 and May 25.

The London six-month Eurodollar rate stood at 12 3/16 Wednesday, rising to 12½ on Thursday, and an incredible 12 9/16 Friday. Earlier in the week, bankers said they were unable to borrow; as the crisis broke, they said they had no choice but to borrow Eurodollars at rates commensurable with or even higher than their prime lending rate.

Commented a senior U.S. official: "The decision has already been made. The Federal Reserve will float the banks off into the sunset on a sea of liquidity." Well-placed Democratic sources at the Joint Economic Committee say that "the Federal Reserve will print money to any extent necessary to bail out any bank, Continental, Manny Hanny, banks in Texas, any bank; you can't set a limit. . . . Shrieks of panic coming from the White House" mean that "the Fed and the FDIC will bail the banks out. So the White House isn't shrieking at Volcker any more, just biting its fingernails."