For the first time since the Czars, Russians test Western bond markets

by William Engdahl

During the early days of January, the European bond market greeted the initial flotation of a Swiss franc 100 million offering that was a booming success—in a period when European markets have been in prolonged depression. The offering was remarkable for another reason: It marked the first time since the Czars, actually since 1910, that Western banks had agreed to float a bond issue for Russia.

The offering was made through a consortium led by the Zurich-based Bank für Kredit und Aussenhandel AG (BKA Bank). The Russian borrower was the Foreign Trade Bank of Moscow. The face amount, some $75 million, is by no means large by present market standards. Nor are the terms the best. "Moscow has gained the same terms that a Class-A or -BBB borrower, say Spain, would get," stated one London trading source. "It got 5% for a 10-year bond. The best rate possible today is about 4¾% for prime borrowers."

Why did Moscow go to the trouble for such a seemingly small amount?

Testing the waters

"Moscow is playing Western capital markets very cleverly," said a senior West German source close to the Bonn government. "They are testing the market. They know that the Western banks have seen a drastic decline in bond business in the last two years. The banks need new bond markets badly." Indeed, according to *Euromoney Bondware* in London, total Eurobond issuance last year plunged 24% to $135 billion, from $178 billion in 1986.

Bonds are the traditional heart of Western capital markets. Borrowers rated "top-grade" are able to obtain the most inexpensive medium- to long-term capital funds available. Little known outside financial markets is the fact that it was the growing crisis in this bond sector in New York, London, Frankfurt, and elsewhere that triggered the Oct. 19 stock market crashes. Since the world depression debacle of the 1930s when flimsy bond schemes for Argentina, Bolivia, Brazil, and other Ibero-American countries were forced into default, those countries have been forced to rely on more expensive commercial bank loans, usually "floating-interest rate" Eurodollar borrowings, whose repayments were adjusted up as interest rates soared to levels of 20% or higher in the early 1980s.

While the Soviet borrowings from Western capital markets have been reduced since the early 1980s, until Jan. 6, they too have been forced to rely on Western bank loans at relatively unfavorable terms.

"The new Russian move to tap Western bond markets should be seen in connection with their decision in 1986 to clean up the old Czarist Russia bond default, as well as their recent request to become full members of the General Agreement on Tariffs and Trade (GATT), and their efforts to negotiate a full recognition by the European Community for the Comecon," a well placed West German expert stressed. In 1986, Soviet Foreign Minister Shevardnadze caught Western financial circles by surprise when he announced during a London visit that Moscow was prepared to settle the 1917 default on old Czarist bonds.

The Russian debt repudiation by the Lenin regime in 1917 was not easily forgotten by Western financiers. As late as 1967, the leading London bankers' weekly, *The Economist*, noted that, "The City of London has never been quite the same since the Russian revolution; the experience of 50 years back has burnt deep."

The bankers' mouthpiece pointed out some 20 years ago, as the Bretton Woods monetary order was then entering its initial breakdown phase, that the leading creditors to Czarist Russia in 1917 "could not grasp that an undeveloped country could develop, albeit at enormous cost, on its own, and thus retain its independence during an industrial revolution. And this inability has had profound consequences on capitalist attitudes toward emerging countries ever since. Before 1917, it had been assumed that no government could repudiate debts and develop, or even survive. . . . The fact that the Bolsheviks repudiated—and survived—was the beginning of the drying up of the flow of capital toward developing countries."

Ironically, now Russia has come back to the bankers of London, and the West, some 70 years later, to offer repayment of the old Czarist bond debt, for a matter of pennies in terms of today's markets. This token, in the context of collapsing Western financial markets, has been deemed sufficient to reopen for Moscow the hallowed sanctuary of Western bond markets, despite the complete police-state control and censorship over economic data by the Russian regime. As the Jan. 6 issue in Zurich demonstrated, Western banks are falling over themselves to grab a piece of what they see as a prime untapped market.

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Playing its German card

The BKA Bank which led the bond offering syndication is a subsidiary of the West Länder Bank, one of West Germany's largest, based in Dusseldorf and tied to the regional government of Social Democrat Johannes Rau. It is also the German bank most intimately involved in financing East German trade. "The Russians wanted to make their first attempt in Switzerland. That's the toughest market for testing something exotic like this, and once they succeed there, they can go into any market," a leading London bond expert told *EIR*. "But the real intent is to tap the West German deutschemark capital market," the *Frankfurter Allgemeine Zeitung* reported.

Discussions are under way to float a second issue, this to be denominated in deutschemarks, for a hefty amount of perhaps DM 500 million. That will be floated from the German "offshore" center called Luxembourg, allowing Russia to take even lower credit terms than the Bonn government because of tax laws. German economic circles report that this second issue will be syndicated by Dresdner Bank, one of Germany's "Big Three" and a bank that has long done business in the East, especially during the financing of the huge and controversial Siberian natural gas pipeline in the late 1970s.

Moscow is targeting the West German economic market, not the United States. But, report well informed senior intelligence circles in Germany, they will deliberately downplay this fact until they have secured ratification of the INF Treaty in Washington. In the meantime, they will take advantage of the eagerness of Western bankers to set the stage for later purchase of large and "cheap" volumes of superior West German engineering and machine tool products in coming months.

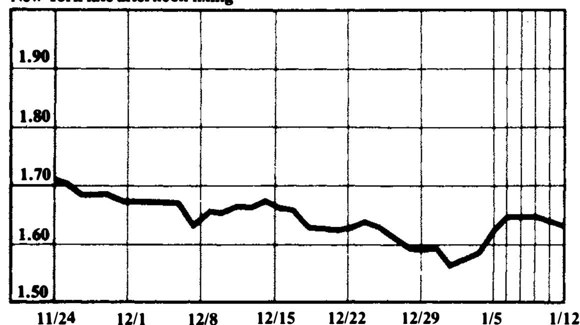
"The Russians are aware that German industry is under pressure and pressuring Bonn because their trade with Eastern markets is sharply down," said one West German economist. Exports from West Germany have been devastated by the high cost of the deutschemark. "Russia earns some 80% of its hard-currency reserves by exports of oil and gas. This is priced in dollars by convention," the expert added. "This means that, relatively, their cost to buy West German goods has gone up more than 100% in the last two years of dollar fall." German exports to the Soviet market as a result are down sharply, with the 1987 preliminary estimate being a decline of 20%, following a similar decline the prior year.

So, Moscow is now smiling as one after another historic barrier into the West breaks down. While their needs are considerable, especially for the most advanced Western machine tool and computer technologies to modernize certain military-industrial capacities, the Soviets will take advantage of what they clearly see to be growing desperation among Western bankers scrambling for new markets. This is the deeper importance of the otherwise little-noticed offering of Jan. 6 in Switzerland by Germany's BKA Bank.

Currency Rates

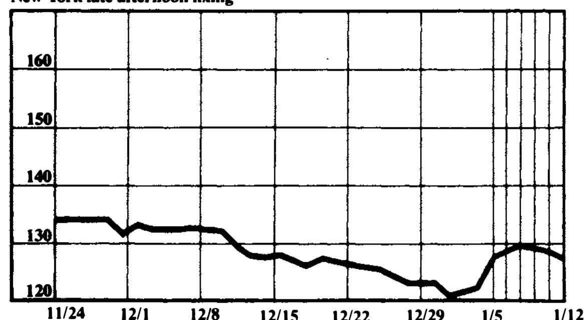
The dollar in deutschemarks

New York late afternoon fixing



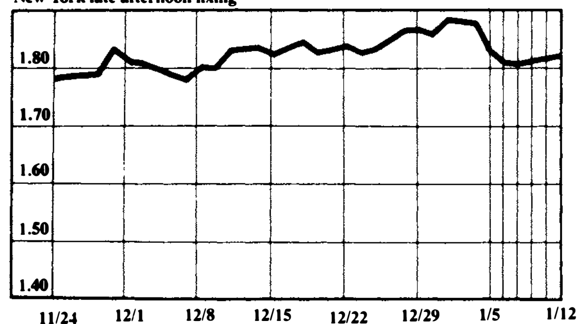
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing