NEW SOLIDARITY
International Press Service

DOMESTIC MARKET LETTER

P.O. Box 1972, G.P.O.
New York, New York 10001
Editorial (212) 279-5950 TWX 581-5679
Customer Service (212) 564-8529

NY BANK LIQUIDITY: IT'S WORSE THAN YOU'D DARE TO BELIEVE

NOV. 28 (IPS)-- IPS learned from one of our most knowledgeable banking sources this week that on the basis of a new study he had undertaken, he had concluded that the proportion of bad loans in the portfolios of Chemical, Chase Manhattan, Bankers Trust, and Marine Midland is not the 40% we had previously thought, but is between 50% and 70%. His study took into account loans to New York City, Big MAC, REITS, W.T. Grant's and other bankrupt corporations, and third world countries; but not tanker loans, loans to bankrupt bank holding companies on the Eurodollar market, or losses associated with leasing operations.

These facts are well-known throughout the investment community. At this point, a well-publicized major default in any one of these areas could trigger a loss of public confidence in the banks, an attendent run on any or all of the three main Rockefeller banks-- Chemical, Chase and Marine Midland-- especially, and lead to a complete blowout. Hence the desperate push by David and Nelson Rockefeller to avoid any semblance of a default by New York City.

Given the gigantic proportion of the dubious assets held by the banking system as a whole, and the New York Rockefeller banks in particular, Federal Reserve Chairman Artur Burns is already orchestrating a low-profile resuce operation, supplying abundant cheap reserves to the banks. However, the major significance of both the Burns operation and the Rockefellers' frantic push for a New York bailout is psychological: the banking community is choosing to overlook the hyperinflationary consequences of Burns' operation and console itself that the Fed stands solidly behind the banks in their hour of need.

A major irony of the present situation is that the large commercial banks, which for over a decade vied for high-yielding speculative loans and investments, are now aggressively competing for the few remaining loans and investments tied to the productive economy. These loans are the only profitable, secure investment outlet for the bank's new found liquidity, and the only means of compensating for the huge proportion of non-earning assets.

CD OUTLOOK STILL BLEAK

At the start of the week the New York commercial banks were once again gripped by the same panic of three weeks ago, when the market in the banks' short term paper, Certificates of Deposit (CDs) deteriorated sharply and rumors of deposit withdrawals abounded. CD rates backed up as a result of the Marine Midland crisis, which broke the previous week, and nervousness about New York.

Following the passage of the New York City tax package in Albany and the partial compromise by President Ford on aid to New York, the CD market improved slightly-- as did the municipal market. However, there will be no long-term change for the better; the awareness of the banking community that the New York crisis is far from resolved is too acute. The market retains nagging doubts as to how short-term and long-term indebtedness will be reayed, and recognizes that the problems of the New York banks run deeper than their loans to New York City and State. CD traders, in fact, are predicting that that market will collapse in December, as banks go into the market for large deposits for much-needed year-end "window dressing", and simultaneously corporations liquidate CDs to meet Dec.15 tax payments.

THE FED TO THE RESCUE

According to a leading New York bank analyst the Fed has been "pushing hard" to force up bank reserves and deposits to cushion against panicky deposit withdrawals, the collapse of bank earnings and outright bank bankruptcies. Another bank analyst said that the Federal Reserve has a take-over plan in place for Marine Midland in the event of a New York City default, "And it will," he added, "only it may be called something else."

To date credit infusions by the Fed have generated a large increase in demand deposits--deposits on which the banks pay no interest--at banks nationwide, and secondly, a low Federal funds rate, currently 250 basis points below the prime rate. In other words banks can earn a hefty 2.5% spread on loans to solvent corporations-- if they can find any.

This situation has produced the beginnings of interest rate competition not seen since the 1930's. First National City Bank has dropped its prime rate to 7 percent, and Bank of America and Morgan Guaranty have dropped theirs to 7.25%. The rest of the banks cannot afford to go below 7.50%; these banks are not in the position to lower their interest rate spreads to compete with the relatively solid banks for profitable commercial and Industrial (C and I) loans. According to Lehman Brothers, large loans losses are forcing most of the banks to build an additional 50 to 60 basis point spread into their rate structure, precluding competitive lending rates.

THE CURE IS WORSE THAN THE DISEASE

It is in fact the build up of the banks' reserves and deposits--the Fed's cure-- which is compelling this scramble for new business loans. The buildup of demand deposits will, in a matter of weeks (barring a total bank collapse), become time and savings deposits, as depositors attempt to earn incomes on them. Once that happens, banks will have to turn this free cash into interest-earning assets.

But potential sources of banking income are becoming scarce.

Tresury bill rates have once again dropped off, making them an unprofitable investment: last week the 13-week Tresury bill rate hovered around 5.5% which, even with the Fed funds rate at low 5.25 percent, yields a spread which covers no more than administrative costs. Business loans continue to contrast sharply. The recent flurry of corporate bond offerings is itself a reaction to the Fed-induced drop in long-term rates. The banks are extremely upset about the departure of primerated corporations for the bond market, where they are borrowing long-term to pay down their bank loans. "It's like sending your kids off to college," one Chicago banker told IPS. "We know it's good for them, but we hate to do it."

The contraction of good C and I laons is actually falling most heavily on the large commercial banks. Outside of the 100 large commercial banks, C and I loans outstanding have increased at an annual rate of 13 percent during 1975. This effectively puts the smaller banks in a position to withstand a bank shake-out than during the 1930's, particularly since most of their loans are industry and agriculture-related.

The Fed faces the following dilemma: if it continues to pump reserves into the banking system to cushion loan losses it will not only create a hyperinflationary explosion, but it will tend to aggravate the rate war described above. On the other-hand, if it tightens up, that will deprive the banks of cheap Federal funds with which they are attempting to hide upwards of 50% bad loans.

DAVID ROCKEFELLER TO NEW YORK:"I NEED MORE"

Bankers are by no means satisfied with President Ford's plan to advance New York City up to $2.3 billion a year in seasonsal loans to be payed back at the end of each year. They are still worried about the repayment of both the short-term and long-term debt. Ford's plan represents only a partial compromise with the Rockefeller banking interests: with Federal money pledged only to maintain essential city services, the banks must still fight out with the working class to ensure that debt has first lien on the City's revenues.

On the other hand, the granting of Federal loan guarantees by Ford would have place the government behind new debt and given a psychological boost to the debt now out-standing.

Less than twenty-four houss after Ford's press conference, David Rockefeller "ordered" a New York Times teelphone interview from his Mainw retreat to declare that four troubled New York State agencies and possibly New York State itself will default in the next three months unless federal loans are forthcoming for them as well-- atepping up the pressure for a complete bank bail out package.

At the beginnign of the week, while the New York City tax package was stalled in the Legislature, the New York banks pulled out of their previous committment to turn their holding of short-term notes and MAC bonds into long-term bonds. One banking analyst told IPS that the banks could not afford to increase their exposure any more--and this is what the moratorium would amount to--unless they are guaranteed massive city and statewide austerity as collateral. Alternatively, the banks would be willing to pull the plug on the city.

Of course, the temporary withdrawal by the banks from the fragile financial package was calculated to put maximum pressure on the legislature and the Ford administration. Following Ford's partial compromise on aid, the Wall Street Journal wittily recounted how the banks and New York City officials had manipulated the President for months; and how he had partially resisted.