market, according to a leading New York house, in the weakness of the soybeans market. Soya, cocoa, and coffee turned weak, since speculation in these commodities depended on excess dollar liquidity in the international markets. In a parallel move, the price of precious metals went up as a hedge against the dollar, among new rumors of Arab funds moving into gold, along with traditional inflation hedges such as copper.

The decision of President Carter to drop his planned tax rebates, criticized as demagogical and inflationary, has temporarily slowed the fall of the dollar on April 14, but his announced energy policies are bound to reaccelerate, both domestically and internationally, the lack of confidence in his Administration.

European Bankers See Major Eurodollar Market Shakeout In Third Quarter

BANKING

Leading Swiss and British bankers expect a major shakeout on the Eurodollar markets by the third quarter of 1977 resulting from the probable failure of Carter Administration efforts to have the International Monetary Fund (IMF) take over a major portion of Third World debts. According to estimates previously circulated by the Swiss Banking Corporation, non-oil producing Third World countries must meet $17 billion in principal repayments alone — not to mention interest — during 1977, the bulk of which falls due during the second and third financial quarters. The Swiss and British bankers surveyed this week now believe that it will be impossible for private international banks to handle this volume of refinancing. The giant New York commercial banks, which have the heaviest exposure, may not survive the third quarter crisis.

Any U.S. Federal Reserve attempt to rescue the New York banks without European support is, moreover, likely to backfire against the U.S. dollar. As a high-level official of one of the three largest Swiss Banks remarked, a single-handed Federal Reserve intervention, which would turn on the printing presses for new dollars, would only trigger a general crisis of "confidence" involving several times more funds than what the Fed is able to mobilize. "How can people conceive of such a scenario conserving their financial holdings!" the Swiss bank official declared.

One source close to the Swiss central bank reported that the Saudis will not give a penny towards an expanded IMF, unless the U.S. government supplies an equivalent amount — and, in Riyadh, it is believed that the U.S. Congress will effectively prevent this. Thus the Carter Administration will accomplish nothing at the April 28 IMF Interim Committee meeting or at the May Economic Summit in London. The entire IMF bail-out package will just fall flat. The following events will then unfold according to this source: "By the second or third quarter, there will be a big contraction in international finance, moratoriums, call it what you will. The United Kingdom and France will push for more stimulation, but it won't help. Confidence will be shattered and exchange rates will move against the dollar."

In London, a spokesman for a leading British merchant bank, with credentials going back to the eighteenth century, attacked the IMF's austerity policies as the reason why the bail-out is getting short shrift. "Either the IMF employs new people, or they get less power — in any case, they're not able to play it as central banker," the spokesman said. "In the United Kingdom, the IMF team behaved like the most extreme type of Montagu Norman bankers — cut, cut, cut — the cuts were all far too severe, and with the funding of the sterling balances we've tied our hands for ten years...If the non-recovery goes on, or becomes negative, the commercial banks in the U.S., who have the prime responsibility for their overexposure, will be in trouble. European bankers have been far more cautious...Major write-offs will be possible, but even with Federal Reserve funding, it'll be too late — there will be withdrawals, a major collapse. The asset side has gone so far that nothing the IMF can do can salvage the situation." He then confirmed reports that the Saudis are opposed to the $16 billion IMF special fund proposed by the Fund's managing director Witteveen.

Other City of London spokesmen expressed a similar lack of sympathy for the plight of New York's commercial banks. Said one merchant banker: "If the U.S. banks are going to collapse, I could not care less. The Fed will help them. Big effects on the dollar too, sure. So what?"

Only N.M. Rothschild and Sons dissented from the general view that the New York banks are likely to be badly shattered. "There will be a major banking and liquidity crisis but not a breakdown crisis," protested the Rothschilds' LDC debt expert De Carvalho.

In West Germany, opposition to the IMF expansion is nearly as strong as among British financial circles but is complicated by fear of a break with the U.S. A representative of a West German business association expressed it best: "Not everyone wants to help the U.S. banks that made so much profit on the LDC lending operations," but the West Germans hope for some kind of "compromise" on the IMF issue to delay having to come to grips with the larger strategic question of a collapse of New York financial power.

As word of the impending third quarter payments debacle spreads, the *Wall Street Journal* has been forced

© 1977 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

to publish a grudging acknowledgement of the banks' difficulties, but denying the depth of the crisis. In an April 14 article entitled "Poorer Countries Face Test of Their Ability to Repay Bank Loans," the *Wall Street Journal* stated: "The question arises whether numerous countries might fail to meet the payments, threatening the solvency of the banks that lent them the money. Executives of the major banks say they are confident that won't happen, although some wouldn't be surprised if a few governments ran into trouble." Nevertheless, the *Journal* quotes Darryl Francis, a former president of the Federal Reserve Bank of St. Louis, to say: "Purely on a gut feeling, I'm a little nervous about this area. I won't be shocked if it doesn't work out as beautifully as they (the bankers) expect."

Tax Rebate Dies — A Small Victory For Sanity

BUSINESS OUTLOOK

The Carter Administration has withdrawn its proposed $11.2 billion tax rebate package, following the Administration's promotion of the rebates for over two months as the indispensable centerpiece of its economic program. The Administration's defeat, forced by a coalition of Republicans and Democrats, throws a roadblock before plans to pump up the U.S. credit supply. From the outset the tax rebates program had less to do with improving the performance of the domestic economy than with emergency relief for the illiquidity of the New York banks. It was intended, first, to facilitate U.S. purchase of Third World commodities at tremendously inflated prices, upon which the Third World was to get sufficient earnings to pay back $17 billion on principal account of debt owed to Wall Street during the next few months. Second, it was supposed to create the funds necessary to finance the direct bail-out of the New York banking majors. A massive hyperinflation would have resulted.

The major congressional opposition to the rebates program was only in part due to the question of taxes per se. Rather it was seized as a vehicle by which Congress could attack other aspects of the Carter "No energy, no growth" budget, particularly the Administration's announced intentions to shutdown funding of 30 domestic water development projects.

Russell Long (D-La), chairman of the Senate Finance Committee, whose state of Louisiana was threatened with 5 water project close-downs, led the conservative Democrats' anti-rebates fight. Long told the Congress last week that, "if we voted right this minute, (the rebates) would be defeated," and added that the Administration "is going to have to call in the top man if they are going to win this fight."

Barber B. Conable Jr. (R-NY), ranking Republican on the House Ways and Means Committee, called the rebates proposal, "very close to throwing money out of airplanes."

Federal Reserve Board member Henry Wallich had hinted strongly in a *Journal of Commerce* interview last month that the effect of the rebates would be to gun the money supply, and thus provide liquidity for the banking system. However, the preponderance of Wall Street bank newsletters warned that the rebates program would end up very quickly driving up short-term interest rates sky-high, thus crippling capital spending and leading directly to wage and price controls. The annual increase of the CPI at a clip of 10 percent for the average of the first three months of this year was more than enough convincing evidence for the business community that inflationary storm pressures were underway.

The effects on the money markets of the rebates defeat was immediate. The Dow Jones industrial stock average rose 9 points on the day, closing at 947, and intermediate securities on the bond market rose a full point. Virtually all intermediate interest rates, down to three month paper, fell a full quarter percent on the news — an unusual drop for short-term paper — and funds began to move out of short-term paper into higher interest rates in deposits.

While the medium term effects of the rebate cancellation will be salutory, by itself it only provides stability for the weak dollar in the very short (4-6 weeks) run.

To Wall Street's more euphoric analysts, the rebate cancellation argued that the period of hyperinflation was suddenly behind; with interest rates falling, and no apparent major loan demand, it was said that the "entire system is swimming in liquidity," in the words of an analyst at Aubrey Lanston. The need to create new credit would be eliminated.

In fact the system only appears liquid because: 1) the Treasury will not borrow, as a result of the rebate defeat, the anticipated $11 billion for rebate payments, which will allow the Treasury to repay about $2 billion in the second quarter rather than borrow the $5-6 billion expected, and 2) virtually no major corporate bond issues are scheduled for marketing during the next six weeks. In addition, New York banks theoretically have more funds available for lending, because New York bank lending to corporations has sharply declined by $1.9 billion since the first of the year. (At the same time, there is considerable lending, about $4.5 billion in the last 8 weeks in the commercial paper market outside the banking system). Far from swimming in funds, the eight major New York banks are in borrowed reserve position of $7.4 billion. Moreover, there are several mounting powerful forces countervailing the apparent lack of borrowing.

First, the Third World will be borrowing a large portion of the $17 billion required to amortize debt principal payment at the end of the second quarter, beginning of