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INTERNATIONAL CREDIT MARKETS

Will tight Euromarkets squeeze out Third World borrowers?

Rising energy prices and tighter credit conditions in the advanced-sector countries have begun to drain liquidity from the Eurodollar markets, signaling the possibility of a renewed debt crisis for developing countries by the second half of this year. Except for the more extreme cases, such as Zaire and Turkey, the developing countries' debt problems have received little press coverage during the past year. This was because U.S. balance of payments deficits and a declining dollar resulted in a substantial flow of dollars into the Eurodollar markets last year, creating a temporary "dollar glut" which permitted developing countries and other borrowers to raise enough credits to repay maturing debts and even to refinance old loans at somewhat better terms.

Although Eurodollar market conditions are still highly liquid at present, this trend may shortly reverse due to the effects of the London-engineered explosion in the price of energy and energy-related raw materials, and an end to European and Japanese fueling of Eurodollar credit growth. The inflation spiral threatens to simultaneously 1) increase the overall *demand* for Eurodollar funds, by sharply increasing the trade and current account deficits of the non-oil producing developing sector as well as of many Eastern and Western European countries; and 2) reduce the supply of available funds, by inducing a heavy flow of Eurodollars back to the U.S. to meet a heightened demand for credit from increasingly cost-strapped U.S. corporations. This reflow back to the U.S. capital markets has, in fact, already begun, as international money managers seek to take advantage of higher U.S. domestic interest rates and the (temporarily) strong U.S. dollar.

Tighter credit conditions in West Germany and Japan could also compel commercial banks in these

DOMESTIC CREDIT MARKETS

High interest rates scoop away banks' business

What the U.S. banking system saw as a boon a year ago—Fed Chairman William Miller's high interest rate policy—has turned into a nightmare for money center and country banks alike. Both categories of banks are losing out on profitable commercial and industrial loans as a direct result of Miller's policy. A year ago when the large commercial banks were applauding Miller, they were blinded to the inevitable implications of his policy by visions of fat interest rate margins. This prospect has now vanished, as corporate loan demand increasingly circumvents the banks for the commercial paper market—cheaper, unsecured IOUs that corporations issue to each other. High interest rates have forced corporations to liquidate capital investment plans, and they are putting out funds in short-term loans. Smaller regional banks have the loan demand, but they find themselves unable to compete for high-cost funds to meet that demand, and are literally turning good customers away from their doors.

The only banks thriving under the current credit market conditions are the British and allied foreign banks which are now making big inroads into the U.S. loan market—both through their acquisitions of U.S. banks and through the stepped-up activity of their U.S. branches. British banks, in fact, are openly announcing their intention to fill the "gap" in the domestic credit markets that U.S. banks are currently too hamstrung to fill: loans to small and medium-sized American corporations, and consumer and mortgage loans.

The March 31 issue of the London *Economist* (see Banking) cited Barclays Bank's $191 million bid for the American Credit Corporation of Charlotte, North Carolina—a finance company with consumer lending, factories, leasing and insurance interests—as the wave of the future.

"America is still in the middle of

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countries to reduce their overseas lending and concentrate on meeting domestic credit needs. Last year, the West German and Japanese banks were responsible for much of the expansion in Eurodollar lending because they could obtain dollars readily from their central banks, which were accumulating them through foreign exchange intervention. The cost structure of the German and Japanese banks also permitted them to lend at lower margins than the U.S. banks. However, the dollar reserves of the Bundesbank and Bank of Japan are dropping off now as the central banks intervene to support their own currencies.

Heavy repayment schedule

The borrowing crunch could be aggravated by the fact that a large portion of the credits arranged in the immediate aftermath of the 1973-1974 oil price run-up happens to fall due this year, and many countries, particularly in the developing sector, will have to borrow to repay principal. Morgan Guaranty's analysts say they expect that new medium-term Eurocurrency bank credits could easily amount to $100 billion in 1979. This compares with $70.2 billion in such credits in 1978 and $41.4 billion in 1977 — that is, more than doubling the volume of credits in two years! Morgan's estimate was based, moreover, on the assumption that oil prices will rise by an average of 20 percent this year, which could prove conservative.

Morgan also estimates that of the total $100 billion in new Eurocredits which will be raised this year, $45 billion must go toward debt repayment and refinancing (again, a conservative estimate). This means that only $55 billion represents actual "new money" which will be available to countries to cover the increased cost of oil imports — much less to finance sorely-needed Third World development projects.

The squeezing-out of the developing countries from the Eurodollar markets will force these countries to choose between 1) default (which could provoke chaos and panic on the markets and result in cutoffs of future credits to the defaulting countries); and 2) direct takeover of their economies by the International Monetary Fund, whose austerity policies will destroy the ability of these economies to recover and pay their debts in the future. The third alternative has been extensively presented by this publication: the establishment of an international development bank, under the aegis of the European Monetary System, which would finance long-term credits for capital goods exports to the developing sector and temporarily freeze or restructure large portions of the existing debt.

— Alice Roth

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its biggest ever banking boom; loan demand increased by 15 percent last year," observed the *Economist*. "The International Banking Act, far from restricting foreign banks, in many ways has given them additional advantages. They have to choose a 'home state'.... but, having already gotten well entrenched in the major money centres, they could (cleverly) choose to establish their 'home state' in some more out-of-the-way spot, where they would be able to snap up local business from under the noses of less sophisticated local banks." The *Economist* noted that America's money center banks would love to capture some of this regional loan business for themselves, but U.S. banking laws forbid them from opening up branches or buying another bank or bank-related business in other states.

In an interview with *Executive Intelligence Review*, John Wilson, branch manager of Lloyds International in New York, named Barclays and National Westminister, which hopes to acquire National Bank of North America, as harbingers of this move into the "hinterlands," but said that Lloyds International, which does wholesale banking business exclusively, will continue to concentrate on loans to major overseas corporations. Lloyds' domestic-oriented branch on the West Coast is already involved in mortgage, auto, and other types of consumer loans locally.

British banking strategy for the U.S. fits the problems of the regional sector—brought on by high interest rates—like the proverbial glove. In various polls over the last several weeks, regional bankers have complained that Miller's high interest rate regime has put them in a squeeze. The smaller regions have been loaning money to longstanding customers at one to two percent below the 11.75 prime rate rather than see them go bankrupt, and simply cannot afford to pay the going rates on certificates of deposit, Federal funds, and other instruments for raising lendable money. The banks furthermore are losing deposits to local savings and loan institutions which are allowed to issue six-month savings certificates carrying interest rates a quarter of a percentage point higher than any commercial bank is permitted to offer.

Bankers Trusts' decision to move into the commercial paper market last summer is indicative of the current plight of the money center banks. Commercial paper outstanding increased from $8 million at the end of 1964 to $89.34 billion as of March 14. The reason for the greater attractiveness of this borrowing market is its lower cost-even with commission, insurance, and other charges figured in.

—Lydia Schulman