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Who pulled the plug on Conti?

Edmund Safra, a business associate of Henry Kissinger, has been implicated, along with European central bankers.

Shadowy Lebanese financier Edmund Safra, who became the largest single stockholder in American Express when it absorbed his Trade Development Bank in January 1983, is reputed to have started the run against Continental Illinois which forced an $11 billion bailout by a combination of federal authorities and private banks.

Despite protests at Amex's stockholders' meeting in early May, Henry Kissinger was elected to the firm's board of directors.

Several different market sources report that Safra, who now heads the international banking division of American Express, yanked deposits from foreign branches of the stricken Illinois bank, starting a run which led even the West German central bank to remove funds.

Coincidentally, banking sources familiar with discussions to merge Conti, the nation's eighth largest bank, report that American Express is an aggressive bidder to take over the Chicago institution.

The following extraordinary item appeared on the Dow-Jones broadtape on May 17:

"Bundesbank Denies Rumors of Conti Ill. Funds Withdrawal. Frankfurt—DJ—A Deutsche Bundesbank spokesman denied as baseless rumors that the West German central bank withdrew deposits from Continental Illinois National Bank & Trust Co. of Chicago.

"Reports from New York cited market rumors about the withdrawal of Deutsche Bundesbank funds from Continental Illinois.

"Bankers in Frankfurt also doubted the rumors, claiming the West German central bank wasn't known to have held any deposits at Continental Illinois.

"Some bankers suggested that the rumor stemmed from the fact that abroad Deutsche Bundesbank is often mistaken as Deutsche Bank, the country's largest universal bank.

"But even at Deutsche Bank sources said the bank was doing business with Continental Illinois but hadn't withdrawn any deposits."

Well-informed London banking sources insist that the West German central bank was, on the contrary, up to its neck in the massed withdrawal of deposits that brought the bank down.

Karl-Otto Pöhl, the Bundesbank president, was the most vocal critic of American budget policy at the May 7-9 meeting of 20 nations' central bankers at the New York Federal Reserve Bank. He was also the first to predict disaster for the United States should it continue to finance its deficit abroad.

Pöhl gave a speech in London May 10, immediately following the central bankers' discussion, warning that the dollar would "overshoot" its real value on the way downward.

Under these circumstances it is no surprise that the Bundesbank declined to tighten German credit-market conditions at its meeting on May 17, a move that had been widely expected in view of the German mark's recent fall against the dollar (although the mark has improved significantly since the Continental Illinois crisis broke). Pöhl commented yesterday that the surprising feature of the situation is that the dollar did not rise much further in view of the huge discrepancy between German and U.S. interest rates. This was proof of market sentiment in favor of the mark and against the dollar, Pöhl concluded.

The relative stability of Eurodollar interest rates and of foreign-exchange parities, London banking sources note, is the result of strenuous intervention on the part of the central banks to prevent panic from spreading—further indication that the central banks had planned for this all along.

However, developments during mid-May destroyed the last bit of maneuvering room the U.S. Federal Reserve had enjoyed.

The Eurodollar one-year rate rose above 13% during the scramble for funds last week in the wake of the Continental disaster, as the rescuing banks sought to fund their loans to the stricken Chicago institution. The six-month rate rose to 12⅝ on May 9, and was still at 12⁵⁄₁₆ this morning. This presents a dilemma inside a dilemma for the Federal Reserve, as follows:

Under the circumstances, the Federal Reserve has no choice but to attempt to bring interest rates down and pump additional liquidity into the system. U.S. Trust, an institution whose management is particularly close to Fed chairman Volcker, sallied in that direction May 19 by reducing its broker loan rate from 12% to 11½%. However, with the six-month Eurodollar rate, the benchmark for banks' funding abroad, still at roughly the U.S. prime rate, the pressure is on the banks to raise the prime.

Without a fall in interest rates, bad credits will become worse. But a fall in rates can only come at the expense of the banks' own profit margins.

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