

Business Briefs

Eurodollar Markets

Bank of England studies interbank dangers

The Bank of England has completed an internal study of the Eurodollar interbank market, a \$600 billion pool of funds exchanged among over 1,000 international banks. According to the London *Financial Times* Sept. 24, the Bank of England report attempts to evaluate the danger of a crisis of confidence leading to a chain-reaction of withdrawals of loans among leading banks.

Such a chain-reaction was narrowly prevented from bringing down the Eurodollar market after the July 1974 failure of Germany's Herstatt Bank. In the two months after the failure, interbank loans declined by one-third due to market nervousness.

European bankers have speculated that American banks' efforts to limit their interbank exposure, e.g. the introduction of same-day rather than overnight settlements of Eurodollar transactions through the New York Clearing House starting Oct. 1, might touch off a crisis.

However, the new Bank of England study argues that the danger of an unmanageable crisis is relatively small, the British newspaper reported.

Transportation

World's airlines take new losses

The world's airlines will suffer a \$2.1 billion after-interest operating loss on international flights this year, up from last year's already dismal \$1.8 billion. The pre-interest loss was the same, at \$900 million, but interest charges were up 33 percent to \$1.2 billion. The new figures are in contrast to predictions of an improvement in the international airlines' financial picture predicted earlier this year.

The figures, released by Raymond Cope, assistant director of general traffic, industry and finance for the International Air Transport Association (IATA), also indicate that despite a \$2.1 billion writeoff in depreciation, there will be zero cash flow, as that entire sum will be needed to cover the red ink in the operating budget. The IATA represents 100 of the Western world's major airlines. Last year the airlines squeaked by with \$100 million in cash flow.

The airlines now have to fund their entire projected \$4 billion budget for fleet and capital improvements from borrowings, leading the airlines to "go into 1982 with a great big debt overhang," according to Cope.

This will raise anticipated interest costs next year an additional 50 percent, to \$1.8 billion, and will undoubtedly cause the bulk of an almost certain operating deficit next year.

The dismal picture results directly from the stagnating economic situation in most Western countries, and from the high interest rates prevailing since late 1979, compounded by the soaring cost of jet fuel.

In the United States, as reported in this publication last month, the crisis in the airlines, exacerbated by the deregulation of the industry in 1978, is being used to deliberately reduce the entire industry by 25 percent or more, jack up the fares, and curtail service severely.

The IATA, however, is expected to study a "strategic plan" developed by the association's executive committee, to deal with the crisis, at its Cannes, France meeting next month.

Domestic Credit

Prime falls, but won't drop much

The expectation that interest rates are really coming down will be short-lived. The leading money center banks lowered the prime lending rate to 19.5 percent Sept. 22, and there is room for the prime to come down as far as 17.5 percent over

the next several weeks. But any appreciable drop in the prime beyond this point should be ruled out.

Currently, Certificates of Deposit of \$100,000 or more at large banks are at 16 percent. This means that the big money center banks could charge 1.5 percentage points above what they must pay to acquire CD deposits, and justify a prime rate of 17.5 percent.

Moreover, until its recent tightening Sept. 23, the Federal Reserve-determined federal funds (overnight interbank) rate stood at a shade under 15 percent, again meaning that based on the bank cost of funds, a lower prime rate is justified.

However, there is a general illiquidity in the U.S. economy. Even beyond the often-cited large U.S. Treasury borrowing needs, there are corporations with \$17 billion of bonds waiting to go to market, and a large pent-up need of funds at the state and municipal level. In Sept. 16 testimony before the Congress, Federal Reserve Board Chairman Paul Volcker stated that the Fed has no intention of accommodating this borrowing need, and this will mean higher interest rates even if there is a short hiatus in which rates drop. Only if there is a massive U.S. economic recession will interest rates drop below 15 percent early next year.

International Credit

Saudis ask French for gold collateral

Saudi Arabia made gold collateral a condition for further large loans to France during negotiations in Riyadh early in September, Paris banking sources report. A French government delegation in search of a multibillion-dollar loan returned empty-handed, they stated.

Official French sources said that the Saudis objected to the new Mitterrand government's bank nationalization program. At most, sources said, the Saudis were willing to lend France \$750 million, or less than a fifth of what the French

delegation had requested.

Apart from their political objections to the new pro-Israeli government, the conservative Saudis do not believe that Mitterrand is a good credit risk. European bankers believe that the high interest rates on the French money market introduced with the government's Sept. 20 emergency package cannot be sustained, particularly since the government is still compelling banks to lend at several percentage points less than their own cost of funds. A major dislocation inside the French credit system is expected sometime in the next several months.

Even more significant is the Saudis' insistence on gold collateral. Starting in 1979, the Saudis and other Arab countries began purchasing gold, to the extent of 10 to 15 percent of their new earnings. Apparently the Saudis are convinced that gold will increase in importance as an additional reserve asset.

Banking

Risky nationalizations proceed in France

The Socialist government of France decided on Sept. 22 to go ahead with the nationalization of 95 percent of the banking industry there. While all the important French banks were clearly understood to be on the firing line, a cabinet debate took place on whether the subsidiaries of foreign banks should be included in the nationalization bill.

The cabinet's decision to include banks with more than 1 billion francs of deposits in the list of those to be nationalized (which will be on the parliamentary agenda this month) particularly threatens numerous British banks which have built dominant positions on the French real-estate market in the last two decades. Midland and Barclays are reportedly among the banks to be nationalized.

Complex and possibly risky situations can develop with foreign partnership in French banks. The London-based S. G. Warburg owns 12.5 per-

cent of the giant *Compagnie Financiere de Paris and des Pays-Bas (Paribas)*, and it reportedly will pull out of regular inter-bank market arrangements should its shareholding be threatened.

East-West Trade

A 'New Ruhr' in West Siberia?

Germany's Economics Minister Otto von Lambsdorff arrived in Moscow Sept. 24 with a large delegation of officials, industrialists, and bankers, in his capacity as cochairman of the German-Soviet Economic Commission. After a first session in Moscow, the commission moves to Novosibirsk, West Siberia, headquarters of the Siberian branch of the Soviet Academy of Sciences.

According to *Handelsblatt*, the Düsseldorf business daily, the Germans intend to discuss Soviet proposals, made over the years to vastly upgrade industrial cooperation between both countries in the energy field. Bonn, the German daily adds, looks upon U.S. proposals for "alternative" German-American energy cooperation, as immaterial, and not worthy of consideration.

The Soviet side, latest reports from Germany indicate, will present a gigantic project, worth a total of 120 billion Deutschmarks: the Soviets now want to exploit the huge surface coal deposits located in West Siberia, and propose that the Germans "build a new Ruhr" directly on the site. The target date for completing the proposed project is between 1990 and 1995.

Frankfurt banking sources, while stressing that such an immense project (which dwarfs the Siberian gas pipeline project signed this year) will take some time to negotiate, make no secret that it is considered vital for West Germany's national interests, and that pressure from the United States or elsewhere could not deter its implementation. Lambsdorff, asked about possible U.S. opposition, replied that he was "informed of no American objection."

Briefly

● **SIR GEOFFREY HOWE**, the U.K.'s finance minister, told his Commonwealth colleagues Sept. 22 that the U.S. must cut its budget to keep down interest rates. Howe's own budget deficit rose 50 percent after his monetarist program brought unemployment to higher levels than the 1930s.

● **INDIA'S** application for \$6 billion in IMF funds comes up for Executive Board approval next month; the Reagan administration "will be quite tough," according to a New York banking source with access to top levels in Treasury. He said he believes the view in Washington is that India could get all the money it wants in international lending markets, if it would only scrap its present restrictions on foreign investment.

● **MITSUBISHI Heavy Industries** announced it will bid for a \$2 billion nuclear plant project by Mexico's Comision Federal de Electricidad, either independently or with its licensor, Westinghouse. If successful, this would be the first Japanese export of a primary system for atomic power plants, as opposed to turbines used in such plants, according to the Sept. 22 *Nihon Keizai Shimbun*.

● **JAPANESE** corporate spending on R&D for the year ending March 1982 will reach a R&D-to-sales 1.4 percent, for the first time the same as that of U.S. corporations. This will be achieved by a 16 percent rise, which follows a 17 percent rise last year. Half the R&D investment is being made by the auto and electric machinery industries.

● **WALL STREET** investors were selling on Sept. 25 out of fear that continued high interest rates will wreck corporate profits. Yet pundits used the market drop to proclaim that Volcker must keep fighting deficit-induced inflation and maintain high rates.