

Deranged central bankers attempt lending clamps

by Laurent Murawiec, European Economics Editor

One of Edgar Allen Poe's most insightful short stories, "The Facts in the Case of M. Valdemar," narrates the "mesmerization," *in articulo mortis*, of a very sick man, and how a suspended lease on life is granted to him in this artificial way, until inevitably, the patient has to be awakened from hypnosis, at which point, Poe's story ends, "upon the bed, before that whole company, there lay a nearly liquid mass of loathsome—of detestable putrescence."

This is the sight with which the international financial community is being presented—of its own doing. Years of a blind policy of refinancing ever-growing masses of worthless financial paper without creating real value in return, followed by a vicious squeeze on productive credit, have brought the whole system to the point of breakup.

The Euromarkets are cracking at the seams. But market developments are simply a reflection of the deeper *political* process spearheaded by the Latin American nations' rejection of the deflationary world order demanded by the controllers of world credit, the world's central bankers and their club at the Bank for International Settlements.

A deflationary order

The September annual conference of the IMF, as *EIR* reported last week, was characterized by Third World debtors' enunciation of their utter inability—and unwillingness—to pay their accumulated \$660 billion liabilities. In response, "international authorities" foolishly elected to pontificate about the Third World's "excessive consumption," to warn that deficits would not and should not be financed, and to

threaten commercial banks in the advanced sector to toe the party line.

The Swiss authorities laid it out in their own quiet, deadly way: "There is going to be a generalized effort to stop net indebtedness from growing, a very deliberate effort to stop the flow of fresh credit to the debtors. Whatever they do, the [Third World] will have to develop a mechanism to reduce their imports. The aim is to return to equilibrium in current accounts, for the whole Third World. There is going to be a cumulative contraction of economic activity. Zero growth in the OECD in 1982, predictable zero growth in 1983. . . . This cumulative contraction will worsen, with no element able to provide a stimulus. There is no recovery in sight. We are headed for a major deflation."

The source of the "putrescence" emanating from the world monetary system is an ideology which dictates that at whatever cost to humanity, the magical precepts of the mechanisms of "free enterprise" must be preserved. During the IMF conference, the delegates were confronted with the consequences of this insanity through the wide circulation of a special document written for the occasion by international economist and Democratic Party leader Lyndon LaRouche. Titled "Conditionality is a Nuremberg Crime," the opening paragraphs spell out the consequences of pursuing the banks' gameplan for reorganization of international debt through further global reductions in living standards. In the opening paragraphs of that document, LaRouche states that we are faced with "the threat of the worst international financial collapse since the middle of the fourteenth century. Now,

as during that fourteenth-century crisis, the usurious practices of the Lombards are accomplishing the common ruin of the debtors and creditors alike. . . . rather than permitting a correction in the foolish 'free-market economy' delusions causing the present depression, the forces which have caused this depression have . . . proposed to destroy entire nations and peoples through austerity-measures, rather than compromise any part of their 'free-market' fanaticism." Since the IMF meeting, this ideology has been at work in the "contingency planning" oozing from central banks. To the extent that the central bankers have determined that a frontal attack on indebted Third World countries had to be ruled out—mainly due to the political opposition to their policies spearheaded by Mexico and Latin America—the emergency measures now under way aim to achieve the same results "through the back door": by means of a major clampdown on the banks.

Fed maneuvers

A New York-based former Bank of England employee now adorning the rooms of the Brookings Institution, was also spouting one of these insane, 'scenarios' of how central bankers were going to re-establish their divine right. "—— will go under," he cited a major New York bank; "Hong Shang will go under, the entire offshore markets will go under, and we'll set up an international banking supervisory board. Offshore entities are privateers riding on the shoulders of governments and central banks," he affirmed with newfound sanctimoniousness. "But now, money is flowing out of the offshore centers. Only New York and London will remain. We will have total leverage, governments will be forced to accept it. Banks will collapse, there is going to be coronary seizure of deposits on the interbank market. We'll have total central bank-controls."

Together with the BIS, the U.S. Federal Reserve has worked out a new set of "accounting policies" which are supposed to allow the banks to "write off" Third World loans, while massively cutting credits to the Third World, Fed officials revealed to *EIR* on Sept. 16.

Until now, as in the case of Poland, the banks have been allowed to carry loans, which are de facto in default at 100 percent value on their books. Poland, for example, has been in default for the last two years, but no U.S. bank has been forced to write off a cent in Polish debt losses. Because Poland had the upper hand due to the Mexico scare, the banks have just given the Poles a soft rollover on their 1982 debt, in which Poland will only pay 5 percent of the principal and 30 percent of the interest due. This situation, theoretically, could also be allowed for Argentina, Brazil, and Mexico, if they refuse to pay, the source said. But this is "politically unacceptable."

Therefore, under "new principles of accounting" laid down in collaboration with the BIS, the Fed will demand that banks start classifying bad debt, initially by small percentages, writing off, say 10 percent of a loan to Argentina this

year, 20 percent next year, and so on. "We will try to manage this so that at no point are too many countries being written off," a Fed official said. "We must prevent the writeoff from being so high a charge to the profits of banks that it threatens the system."

The writeoffs not only protect the banks from threats by debtors—who, after writeoffs, will have less leverage over the banks—but have the added advantage of forcing banks to lend less overall to the Third world, the Fed source stated.

Another Swiss spokesman stated, "Mexico has had an 8 percent growth rate these last years. They would have had to stop anyway. Why can't they stop growth for a while? Just one year or two? Just to adapt! You *cannot* keep on growing at such rhythms! To stop growth a while, that's not the end of the world!"

That leaves the sphere of economic policy and becomes the sort of obsession requiring medical attention. To further one's understanding of the wicked, sick minds that still claim the prerogative of running world financial affairs, read the Sept. 13 editorial of London's *Financial Times*, "A Postscript to Toronto," complaining that if "some useful progress was made toward underpinning the creaking structure of international credit yet the partial rebuilding of the structure was not discussed and may yet prove unavoidable."

After advocating great IMF powers and more IMF money, and heavier official supervision of banks, the City newspaper declares: "What is now needed is some imaginative thinking about ways of *refunding* part of the debt of insolvent countries to lessen their threat to and dependence upon the banks and to replace short term floating rate loans with long-term finance on the least onerous terms possible."

How, Sir? With turning the new IMF facility proposed by the U.S. Treasury under the name of special fund into a "refunding facility" issuing long-term, IMF-guaranteed bonds on the markets in order to buy at a discount the rotten, nonperforming bank debt of bankrupt debtors. Why so? "The pressing need is for contingency plans to replace a substantial amount of sovereign bank debt when and if the *credibility* of such debt to the banking system can no longer be sustained."

Maintain the fiction of life without its substance: Edgar Allan Poe was describing more than magnetic phenomena.

The state of the Euromarkets

The Euromarkets have turned into a Frankenstein's monster that has escaped anyone's control. And the deformed creature is now falling apart. Eurobonds issued by U.S. and Canadian banks have been hit by three successive waves of panic selling. One Bank of America bond is trading at 92 of par! In two weeks, these securities have lost 3, 4 or more percent of their market value, and this is effectively shutting most banks, be they American or not, out of the bond markets. Banque Nationale de Paris learned that being French shuts them out of the fine-terms league. Danish paper is being dumped as the country staggers into bankruptcy. As for the "Third World," to float a bond, Mexico would have to offer

yields of upwards of 30 percent, Argentina of 25 percent, and Brazil of 20 percent.

Only a handful of top, triple-A U.S. corporations, or a tiny minority of sovereign borrowers, e.g., New Zealand and Uncle Sam, are now able to command the best terms, along with a rapid shrinking platoon of international banks.

On the certificates of deposits (CD) markets, premiums and differentials are widening according to the frightened risk-rating assessment made by banks. Not only has there been a massive, accelerating flow out of bank deposits, which has deprived banks of crucially needed resources—the Euro-interbank market has started to contract, as banks have, systematically if prudently, been reducing their credit-line exposure to fellow-banks. While statistical data are not available, it is known that a process of “tiering” has set a dividing line between a vast majority of banks assessed as a risk, and the handful of “risk-free” banks. CDs now must yield about 2.5 percent above same-maturity U.S. Treasury bills to find buyers.

Italian banks are ostracized since the Ambrosiano affair. Scandinavian banks have to pay more, because they are seen drawing heavily, more than normally, on their credit lines. Most German banks are paying the price of their potential bad-loan troubles. CD issuers, additionally, must accept much shorter maturities than they either wish or absolutely need to avoid severe maturity mismatching.

The offshore markets are being quickly drained of liquidity—so quickly that trouble is indeed expected soon, or a virtually total transfer of the offshore operations back to on-shore branches of banks—with the implied bringing under regulation of the masses of liquidity thus transferred. “All in all, what’s happening means a significant increase in the cost of financial intermediation,” one banker said, “and a contraction of the interbank market. Sources have already dried up to a great extent with the disappearance of OPEC surpluses. . . .”

“Good” Euro-debtors are becoming rare birds. Brazil, for example, the second most voracious Euro-borrower, even though it is politically wooed by the BIS and the IMF, has already suffered in the last few weeks a total drying out of new loans from banks—including German banks, which are now virtually boycotting it. Debts of various dimensions now explode every day, from Bolivia, just declared in default, to Ecuador, which loathes a visit to the IMF but cannot pay its 1982 maturities, to Argentina (see article, page 10).

“All the debts certainly cannot be repaid. Therefore, we’re going to reschedule, gradually, all of the loans to the Third World. We must do this in as orderly a fashion as possible, to prevent, at all costs, an international banking collapse,” one of them said Sept. 16. “There will be case-by-case handling of each Third World debtor, to ease the rescheduling and prevent crisis.”

“Credit won’t totally vanish,” one senior European central banker said, “There will be market-tiering, and a total freeze of loans to quiet a few countries. But we’ll muddle

through. . . It won’t collapse. The question is that of the speed of the global deceleration. It will not be a global freeze, but a gradual cooling off. I agree that major reschedulings are inevitable, and frequent ones at that, given the maturity profile. Of course, this all means depression, an additional depressant factor added to an already stagnant world economy. But please, no collective debt rescheduling, but a case-by-case treatment, seriously negotiated!”

“Collective debt rescheduling” is the Venetian diplomatic term for the danger facing banks that developing-sector nations will join Mexico, unleash a “debt bomb,” and simply refuse to meet payments on the terms the banks have outlined. “Even though Brazil, Mexico and Argentina deny the existence of a formal agreement—will a debtors’ ‘cartel’ hold the banks hostage?” *La Repubblica* of Milan headlines a major article on Sept. 15. “New York financial circles are haunted by the specter of a ‘syndicate of Latin American debtor nations. . . for the moment, Brazil, Mexico and Argentina deny. . . . Creditor banks and in fact the whole international financial system have become the hostages of the colossal Latin American debt. . . [This] strengthens the Latin American countries’ ability to put pressure on banks and international institutions. . . .” “We do not need to purchase weapons any more, our best weapon is the debt,” said a Latin American banker.

Similar articles appeared scattered in the international press. “Debts are [Mexico’s] strength” was the headline on the *Frankfurter Allgemeine Zeitung* article, acknowledging that “Mexico finds itself in a position of strength.”

The economist and former Banque de Paris et des Pays Bas board member Jean Denizet warned in the daily *Le Figaro* on Sept. 11 that “orthodox” methods of handling the debt lead either to hyperinflation or brutal deflation, he stated, “One may well assert that the world’s financial establishment, the IMF, the BIS, the main central banks . . . have underestimated the severity of the over-indebtedness that has built up for the last 10 years, virtually without any accompanying buildup of growth of investment. One cannot imagine a physical growth fast enough to be able to prop up the masses of claims and debts built up on nothing throughout the world. What would be needed would be a world policy to revise debt according to objective criteria.”

What generates panic among central bankers is not so much the disintegration of the Euromarkets—after all, they were privately explaining quite peremptorily a few months ago that they intended to provoke a “limited, secondary banking crisis in September, a pre-emptive strike to cleanse the markets and discipline them.” What has the central bankers on the run is the debt bomb. The sweeping decisions implemented by the President of Mexico towards debt reorganization have discredited and destroyed the rules of the game they have run for decades. In the new geometry generated by the “debt bomb” they are but the still somewhat powerful, but obsolete, remnants of an age past. How understandable their panic!