

The U.S. banking system after Argentina

by David Goldman

In 1897, an Italian anarchist drove a stiletto into the heart of the Austrian Empress Elisabeth, who, not understanding that she had been stabbed, walked several hundred paces and fell dead. Some observers are astonished that the money markets showed practically no reaction to the Argentine crisis during the week ended March 30—on the contrary, interest rates fell somewhat and securities prices were slightly higher—at a point where senior administration officials and banking analysts are debating whether such large commercial banks as Manufacturers Hanover can survive the next several months.

Earlier that week, the attention of market participants had been misfocused on the deliberations of the Federal Open Market Committee, the Federal Reserve System body that supposedly sets monetary policy. An expected tightening of credit did not materialize. On Monday, March 26, the federal funds rate (overnight rate for interbank loans) stood at 10.5%, and had fallen to as low as 5% by Wednesday, before snapping back to slightly over 10% on Friday afternoon; contrary to expectations, the Federal Reserve did not raise its discount rate.

Temporarily lower interest rates provided a soporific to a market whose trillion-dollar offshore branch has suffered from a “slow-motion panic” since early March, when some of the major banking creditors of Argentina found themselves unable to raise funds in the Eurodollar market without paying a significant, and dangerous premium. These include not merely Manufacturers Hanover, the subject of emergency merger studies at New York accounting firms and at federal regulatory institutions, but also some of the offshore subsidiaries of Citibank. A large rollover date for banks’ Eurodollar liabilities passed quietly March 30.

The solution maintaining the calm, however, holds the promise of major developments to come. The Federal Reserve dumped some money into the markets, and the Treasury

released reports of a “bridge loan” to prevent Argentina from ending the month with more than 90 days’ arrears on its loans to major American banks. The loan did not materialize, because Treasury lawyers decided that the funds available for the exercise, the Exchange Stabilization Fund, could not be lent under circumstances where no future loans were in evidence to repay the “bridge.” This consideration led, finally, to the incredible charade announced the evening of March 30, in which Venezuela, Mexico, Brazil, the banking creditors, and *Argentina itself* have each committed \$100 million to provide an emergency \$500 million package to Argentina (see article, page 6).

Supposedly, this will enable U.S. bank regulators to pretend that the overripe Argentine loans do not have to be classified “non-performing,” and that big American banks will not have to stop accruing the income from such loans, and permit everyone to go home happily, until the June 30 inspection of the books rolls around.

In reality, the Federal Reserve has merely given the British and Swiss banks who precipitated the Argentine crisis the choice of 1) blowing out the American dollar during the second quarter, taking the long-term bond markets with it, or 2) declining to continue financing either the American banks or their major debtors, forcing a banking crisis. The “buyers’ strike” against the Treasury’s \$15 billion refunding operation March 29 and the weakness of the dollar throughout the week suggests that the former option is already in progress, but which way the damage is sustained is really a matter of European bankers’ whim at this point.

The Treasury is not legally positioned to bail out the Argentine mess, let alone the series of crises which will follow its example. The Federal Reserve’s printing press will be left with the bill. This may take the form of a frantic effort to bring down banks’ cost of funds to enable them to forego

the interest on loans equivalent to their stockholders' capital which are no longer accruing, or it may take the form of a direct bailout of some major institutions. In either case the effect is the same, i.e., the one identified by Bank for International Settlements president Fritz Leutwiler last September. The American central bank will have to throw out its much-prized "monetary targets," and create a mass of liquidity to prevent a banking collapse, re-starting the run against the dollar, and a run by foreigners against the long-term debt market in U. S. dollars.

United States a net debtor

This will put the United States where the Swiss bankers want it, accelerating the already extensive domination of U.S. financial markets by private European financial entities. The single most important policy statement by an administration official was made by presidential economic adviser Martin Feldstein. He warned in congressional testimony that by the end of 1984, the United States would be a "net debtor nation," i.e., will owe more to foreigners than foreigners owe to the United States. Previously, Feldstein's Economic Report of the President released this February had argued, "In 1984 the U.S. current account deficit is forecasted [sic] to be roughly 40% the size of the Federal Government budget deficit. This means that a capital inflow from abroad is financing the equivalent of 40% of the budget deficit, and the crowding out of other sectors of domestic demand is reduced correspondingly. International capital flows of this magnitude are consistent with the increasing integration of world capital markets."

U.S. banks passed the line into dependency on external financing during the third quarter of 1983, when they borrowed from the Eurodollar interbank market at a \$53 billion annual rate. Previously, American banks had been net creditors of the interbank market, and, following the exhaustion of the OPEC payments surplus during 1982, had become the principal source of new funds to the market.

Although data are not available after last year's third quarter, it appears that the dependence of the banks on such inflows increased substantially since then. During March alone, three major loans taken out by Atlantic Richfield, Texaco, and Socal brought \$35 billion Eurodollars into the American banking system.

Signals from the Eurobond market

The biggest financing operation ever on the Eurobond market was completed in late March, and it shows what the Swiss intentions are. The European *fondi* are simultaneously forcing up the interest rate which America must pay to obtain foreign funds, while preparing to turn their emerging "net creditor" status into a dominant equity position in the U.S. economy. This is the "debt for equity" grab, applied domestically, which the Kissinger-dominated Reagan administration has foolishly encouraged for Ibero-America.

Texaco, which borrowed \$8 billion in February to buy

Getty Oil from a consortium led by Chase, has issued an \$800 million convertible debenture (bond convertible into equity upon demand), the largest-ever convertible issued on the Eurobond market. The leading Swiss newspaper *Neue Zürcher Zeitung* commented March 28 that this issue shows "that the Eurobond market, now in existence for 21 years, has reached maturity," i.e., can rival the domestic U.S. bond market.

The Zürich daily added that "the transaction showed some new developments which could be trailblazing. For example, the creation of regional sub-consortia, reminiscent of international syndicated credit business, helped to ensure the frictionless placement of the issue." That is, the Swiss took half the whole thing (led by Crédit Suisse-First Boston), demonstrating what the *NZZ* called the "enormous placing power of the Swiss banks."

Most interesting are the terms. Usually the interest on convertible debentures is low, reflecting the option to convert to equity, while the premium for equity conversion is nominal. In this case the interest rate of 11 7/8% is nearly at market levels, while the conversion premium of 28.62% is unusually high.

At this date the high conversion premium will be of small importance. Clearly the Swiss are not confident that the Persian Gulf will remain open for very long, which implies that Western Europe will fall to Soviet dominion.

Chase Manhattan Bank is preparing a similar issue to raise capital. The formula is somewhat different, but the principle is the same. It will issue debt with an interest rate determined by a spread above the Treasury bill rate, and repay part of the principal in equity. In effect, this is a convertible debenture at a market interest rate, rather than the usual lower-than-market interest rate.

The Swiss equity interest in the United States is of special significance. Large European fortunes will have to find a home in the United States in the relatively near future as a hedge against Russian influence in Western Europe. This is not a matter of capital fleeing to "the last citadel of capitalism," as is frequently presented. On the contrary: One-third of all Eurobond issues are currently denominated in European Units of Account (see Foreign Exchange, page 15), and some leading European financiers foresee the integration of the European Monetary System into a broader arrangement dominated by the Comecon's transferable ruble. In some respects, the growth of Soviet trade with Europe relative to the collapse of world trade holds money at home.

However, the Soviets are likely to play the game by very rough rules as long as Europe officially adheres to the Atlantic Alliance, and, especially, as long as France continues to support the American beam-weapons initiative as a means of strengthening NATO. The Swiss and their European friends plan a new wave of flight capital into the United States; they would prefer it to occur when the dollar is weak and American equity is a bargain, but they are locking up certain critical equity positions already.