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Citibank's problems: prelude to banking crisis?

by David Goldman and Kathy Burdman

Senior Soviet officials are spreading the word through influential circles in Europe and the United States that a global banking crisis, triggered by major bankruptcies among Third World debtors, will ruin President Reagan's chances for re-election—a view published by the London *Economist* in its first title story of 1984, "Why Reagan Should Not Run Again." Sources close to the President warn privately that unless the Reagan administration takes steps to master the crisis, the Soviet estimation may be correct.

During the third quarter of 1983, reports the Bank for International Settlements, American banks for the first time became net borrowers (of $10 billion) from the Eurodollar market, rather than providers of funds, as in the past. That is to say that the U.S. banking system as a whole is now dependent on the global whirl of flight capital; the dangers for the American economy, not to mention President Reagan's re-election efforts, are obvious.

The immediate center of concern is New York's Citibank, the principal victim of the Philippines' de facto debt moratorium declared in mid-January. Starting Jan. 18, Citibank's Manila branch, which holds $500 million in U.S. dollar deposits on the Asiadollar interbank market, was hit with a run by Japanese and other banks that had deposited dollars there.

Citibank's Manila woes, which have already broken in the financial press, are the visible side of "panic conditions" in the trillion-dollar interbank market, as well as a policy brawl among top institutions, regulatory agencies, and the Congress over the Third World debt crisis. The brawl takes the form of a dispute over a carcass among buzzards, wolves, and jackals, but *unless the Reagan administration rapidly moves to renegotiate the entire Ibero-American and other bad debts of developing countries at long maturities and low interest rates, the principal beneficiary will be the Russian bear*.

Soviet hand in the Philippines?

Although press reports attributed the run to fear over the Philippines' debt crisis, which provoked the country's central bank to ban all transfers of foreign exchange, matters are not so simple. Bank of America, the Hongkong and Shanghai Bank, and Chartered Bank, all of which hold big dollar deposits in Manila, were unaffected, suggesting some prior agreement between the Japanese depositor banks and the British institutions, based in Hong Kong and Singapore.

The two British banks, in turn, are the Asian hub of Lord Peter Carrington's attempt at a strategic deal with the Russians, which includes an effort to preserve the British presence in Hong Kong through the intermediation of Soviet pressure on the Chinese. The leading policy influence at the "Hongshang" Bank is the London merchant bank Morgan Grenfell, Lord Carrington's bank and the semi-official financial arm of the British foreign office.

The Philippines crisis itself, provoked by the assassination last year of anti-Marcos politician Benito Aquino, bears the trademarks of KGB destabilization.

Under the foreign-exchange freeze imposed by the beleaguered Marcos government in October after the International

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Monetary Fund's refusal to grant emergency cash to the Philippines, the country's central bank withheld dollars from the Citibank Manila branch—forcing Citibank to freeze a half billion dollars in interbank deposits.

"The Manila deposits had matured and the banks simply wished to withdraw them. However, we were not permitted to allow this under the current exchange laws of the Philippines. In fact we would have had to get the dollars from the central bank of the Philippines and they refused to make them available to us. So our hands were tied," Citibank's international department chief, executive vice-president George Clark, told *EIR* Jan. 27.

Clark insisted that nothing whatever is amiss—a viewpoint that falls short of credibility under the circumstances. "There was no run. The deposits had simply matured and the banks wanted to withdraw them. These were only normal business withdrawals. I don't believe the idea that there was or is any Soviet involvement. These are just normal business operations," Citibank's international department chief said.

Banks that could not redeem their deposits nonetheless "retaliated with a vengeance" against Citibank, one regional banker said. Banks' eagerness to kick the largest New York bank when down is not surprising. Citibank blackmailed other institutions to sign up for the just-concluded $6.5 billion Brazil bailout loan by threatening to shut them out of the interbank market. Now it is Citibank's turn in the barrel.

According to White House sources, the falling-out has provoked "panic on the interbank market," not in the sense of withdrawal of interbank funds yet, which would produce immediate disaster, but "tiering" of deposits away from Hong Kong, Panama, the Bahamas, and so forth, in favor of North America and Western Europe; this has dangerous implications for the finances of an entire array of countries and banks operating out of them. "Citibank is not in immediate danger, but the potential is there, since it is most dependent of all the banks on interbank funds," said one White House economics adviser.

Fight at Council of the Americas

A sudden threat by Citibank's chairman Walter Wriston to pull his institution out of the Council of the Americas, David Rockefeller's banking policy vehicle for Ibero-America, betrays how much high explosive might be touched off by the Philippines affair and its secondary effects.

The Council had prepared a report recommending that banks convert some of their (unpaid and unpayable) dollar claims on Brazil, Mexico, and other big debtors into "blocked" local-currency accounts, and use them to buy up sections of the stricken nations' economies (see article page 9). The same plan, reminiscent of the British Empire's stripping methods, found its way into a Jan. 24 speech by Commerce Department Undersecretary Lionel Olmer in Washington.

"If developing countries are to grow and repay their international debts, ways must be found to insulate trade credits from financing," Olmer said, "the brunt of developing-country economic adjustment cannot be borne much longer by developing country trade accounts. The recent trade surpluses of key developing countries have been attained mainly through deep import cuts rather than export growth. . . . A flexible approach to the LDC interest rate question is therefore necessary. Some banks have suggested that they would allow some interest payments to be made in local currency, provided there was a guarantee of future convertibility into dollars. This would . . . make dollars available for imports."

Federal Reserve sources say that the bank regulators, under prodding from Fed Governor Henry Wallich, have already agreed to change reporting procedures as of Jan. 31 to permit the banks to take debt-service payments in the form of local-currency accounts, rather than dollars.

But Citibank's Wriston, Washington sources say, used his immense pull to block release of the Council of Americas report recommending the introduction of "blocked accounts" in domestic Latin American currencies. The decision has been made on the administration level, a source close to Fed Chairman Paul Volcker said today, to have the regulators just tell the banks to take their interest payments on Latin American debt in domestic currencies, "blocked accounts," and not in U.S. dollars.

"The fact is," said a well-placed administration official specializing in Third World debt matters, "that the regulators may decide to look the other way if Citibank gets its Brazilian interest payments in cruzeiros, but Citibank's stockholders and depositors won't. Everybody knows that Citibank has a huge percentage of its income from dollar interest income from Brazil. Any reduction in that dollar income from Brazil would really hurt Citibank's stock."

"Walter Wriston is really freaked out," the official added. "The Council of the Americas [the Rockefeller Debt Commission] had recommended in its report recently the proposal for dollar interest payment deferral [into blocked accounts]. But Walter Wriston forced the report to be embargoed to stop that recommendation. He threatened to pull Citibank out of the Council of the Americas unless they removed that recommendation.

"I don't know exactly what's bothering Wriston but Citibank is certainly playing hard ball. First they almost shut down the Council of the Americas, now they are in big trouble in the Asian interbank market for not cooperating with other banks.

"Furthermore, Moody's last week downgraded the bonds of nine of the major bank holding companies, including Citicorp, from AA to A. So Wriston must be worried about that."

The content of Wriston's nightmares is evident: All the banks that signed the $6.5 billion Brazil package in New York have a foolproof escape clause against actual disbursements of their commitments. Brazil told the International Monetary Fund Jan. 25 that it cannot meet the existing conditionalities; the banks' contract releases them if Brazil cannot meet the IMF's impossible terms. In a study widely

reprinted by the Brazilian press, *EIR* revealed in December that most banks participating in the Brazil loan signed under pressure, and have no intention of disbursing.

As *EIR* reported, Brazil ended the 1983 fourth quarter by kiting checks to its bankers in order to bring its arrears under the 90-day cutoff, past which all loans to Brazil would have been judged non-performing by bank regulators. Although debt-service payment checks bounced in the first week of January, Brazil's arrears stood at "only" 88 days on Dec. 31. The March 31 deadline will rouse the default monster again, with redoubled strength.

Citibank, among others, is out on a limb; its exposure in Ibero-America is the highest of any major bank. At the end of 1983, Citicorp had $5.8 billion in stockholders' equity, versus $2.1 billion in non-performing loans officially reported by Citibank.

Of these non-performing loans, $2 billion were officially reported to be foreign loans as of the end of the third quarter of 1984. We estimate the portion of that official $2 billion figure which is to Latin America to be at least $1.5 billion.

But in fact, Citibank's non-performing loans are much higher, at least twice their officially reported figure, i.e., over $5 billion—almost 100 percent of capital. Argentina owes $12 billion in debt service this year which it cannot pay; Brazil owes $17 billion in debt service this year which it cannot pay; Venezuela owes $18 billion in debt service this year which it cannot pay; Mexico is paying only slowly. In the fourth quarter of 1982, Citibank itself reported $18.9 billion exposure in Latin America. We estimate their end 1983 exposure in Latin America conservatively at $20 billion.

Therefore, if in fact, last year 25 percent of those loans were really bad loans, then Citibank's non-performing Latin American loans should have been reported as at least $5 billion which was not being paid on time.

If their Latin American non-performing loans alone were $5 billion, their total non-performing must have been well over $5 billion, or approaching 100 percent of capital.

Brawl in Congress

Sources close to House Banking Committee chairman Fernand St Germain (D.-R.I.) say they will oppose attempts to shift bank regulations to permit "non-dollar accrual" of debt service in any event. An administration source said, "All will change on Jan. 31. There will be new regulations. The regulators will change their procedures to allow it. The regulators have decided . . . to accommodate these sorts of payments. . . . [Commerce Secretary] Baldrige has sent a letter on this to Donald Regan and [Special Trade Representative] Bill Brock, and it is working its way through the policy apparatus."

Not if the House Committee can help it, one senior aide said. The new regulations would be "the real end of the Bretton Woods system. . . . The dollar would then be linked to the Latin American currencies and out of the control of the U. S. government. Any regulation which allows the banks to accept foreign currencies for dollar obligations means that the foreign monetary authorities now have the ability to create dollar liquidity!"

An *EIR* spokesman stated: "This policy is completely unconstitutional. It would loot these countries, because as their currencies depreciate on the markets, they would have to pay more and more local currency to pay the debt. Worse, it would turn these countries into mere branches of the offshore, unregulated Eurodollar market."

Commerce's Lionel Olmer reveals his currency plan

From the address by Lionel H. Olmer, Undersecretary for International Trade, U.S. Department of Commerce, before the Financial Times *conference on Jan. 24:*

. . .There is some reason for cautious optimism. Widespread debt, trade, and financial problems in the developing countries have not led to the collapse of the world economy, as some have feared. Despite the traumatic events of the past one and a half years, relative order has been maintained and good news has emerged on several fronts:

- *The developing-country economic adjustment process is underway.* The most notable success story is Mexico—where the recent wave of Latin American debt crises initially began in August 1982. Through skilled handling of the situation by President de la Madrid and his new government, Mexico has thus far achieved a sharp turnaround in its external accounts. . . .
- We are also encouraged by indications that developing-country *governments and commercial bankers are taking "nuts-and-bolts" trade credit issues more into account when formulating new borrowing* requirements. Initially, responses to developing-country debt problems focused on macro-financial implications, especially for the world banking system and the impact of a failure to meet interest payments. Little attention was paid to trade financing issues. It is heartening to see a growing recognition of the complex linkage between finance and trade, and the need to address *all* aspects of developing-country debt problems. . . .

In my view, the brunt of developing-country economic adjustment cannot be borne much longer by developing-country trade accounts. The recent trade surpluses of key developing countries have been attained mainly through deep import cuts rather than export growth. This has contributed to recessions which undercut political support for the economic adjustment programs. Although developing-country exports should pick up as demand increases in the industrialized world, there are indications that current low levels of developing-country imports are impeding their efforts to pur-

sue economic adjustment goals in an orderly way. . . .

Ideally, the adjustment programs *should* allow for a shift in resources to the export sectors. This would help increase the competitiveness of the exported products and probably diversify the export base. A rapid drop in lending to these countries prevents this diversification by denying access to necessary imports as well as to capital for required investment. And thus far, investment has been declining in almost all the high debt countries. . . .

These developments and trends make it evident that despite some progress at coping with developing country debt problems, there is yet a long way to go. . . .

Last fall, the Commerce Department hosted a meeting between U.S. banks, multinationals, exporters and other members of the administration to review problems in trade finance and investment in high-debt countries. We asked participants to give us their views on how to deal with these problems. Let me briefly summarize some of these ideas:

They suggested that ways be found to reduce the risks and delays in Exim or private bank lending, by enabling the foreign borrower to pledge future export receipts to repay the loan; by collateralizing loans with warehouse receipts of products actually shipped to the U.S.; to include strategic materials which Exim or private banks would use to cover risks; and by having Exim increase its coverage of interest payments in return for the private banks absorbing more risk on loan principal (this would be designed to prevent bank loans from being classified as "non-performing").

We have also had suggestions on how to facilitate trade without the direct use of dollars—either through clearing arrangements as many debtor countries are doing at present, or by setting up mechanisms for use of local currencies. For example, allowing overdue purchases of goods in the debtor country, or against capital investments in the debtor country. . . .

. . .Very high profit margins on new loans endanger the borrower's ability to repay, and ultimately can undercut the quality of the banks' developing-country loan portfolios. In other words, in certain instances, high "risk premiums" become self-defeating. *A flexible approach to the developing-country interest rate question is therefore necessary*. . . .

On the other hand, lowering of interest rates may reduce the incentives needed to keep banks lending. Consequently, *some banks have suggested that they would allow some interest payments to be made in local currency,* provided there was a guarantee of future convertability into dollars. This could reduce the amount of dollar borrowing required and, most important, *would insulate trade credit lines from further reschedulings by making dollars available for imports*. . . .

. . .As developing country debt problems will be with us for some time to come—*establishing a mechanism that would insulate trade credit lines from payment difficulties can reestablish the lifeline needed to help developing countries grow and repay their debt*[emphasis in original]. . . .

Conference Report

The creditors' cartel looks to countertrade

by Stanley Ezrol

The Swiss banking oligarchy sponsored a small conference at Washington's Mayflower Hotel on Jan. 24 to announce their "final solution" to the Ibero-American debt crisis, taking advantage of the failure of the debtors to form a debtors' cartel against the bankers' austerity. The conference, titled, "Beyond the Debt Crisis: New Directions in World Trade," was sponsored by the London *Financial Times* and *International Reports,* the intelligence magazine founded by Swiss banking consultant Günther Reimann; speakers included Federal Reserve Board Governor Henry Wallich, the Basel Bank for International Settlements' representative in Washington; David Devlin of the Ditchley bankers' cartel; and Undersecretary of Commerce Lionel Olmer, who keynoted the event to give the administration's seal of approval to the policies announced.

The Mayflower Hotel event culminated the process launched by a Commerce Department conference with David Rockefeller's Commission on Latin American Debt last autumn, which resolved to use the debtors' illiquidity as a pretext to strip the assets of the Third World. David Devlin, speaking for the Ditchley cartel, said bluntly that the Ditchley "information" service is not "innocent" because when it reports that a country has "broken the IMF conditionalities," that country is cut off from all loans.

Wallich, opening the conference, explained that the "period of adjustment" now to be initiated was only made possible by the failure of the Ibero-American nations to repudiate IMF conditionalities. "They're going through real agony," he said of the debtors under the IMF austerity program, but "I don't think we need have any great qualms about the hardships of these countries."

Wallich thereby confirmed the charges of *EIR* founder Lyndon H. LaRouche, Jr. in a Jan. 20 press release "IMF Bill May Be Unconstitutional," that the bill's authors are involved in a plan to impose genocide through "famine, epidemic, and related conditions." As *EIR* reported Jan. 17, Wallich is the author of a portion of the IMF bill which would cut off all credits to the poorest nations by imposing penalties on lenders to them.

Wallich and other speakers including Edward Brau of the International Monetary Fund, Devlin, and Olmer, praised the example of Mexico's compliance with the IMF at the cost of officially projected drastic increases in hunger for 30 per-