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Central banks send out alarm signals

More crisis management means more crisis, the Western central bankers reason.

International Monetary Fund Managing Director Jacques de Larosière projected a $100 billion current account deficit for the world's poorest countries in a speech last month, confirming an estimate first made in *EIR*. The IMF, the official arbiter in such matters, has, in effect, sent out a danger signal by issuing an estimate of Third World financing requirements double the actual figure for 1980, and substantially higher than the standard commercial-bank estimates.

The IMF's parallel regulatory center, the Basel-based Bank for International Settlements, issued a similar danger signal in its just-published review of second-half 1980 lending patterns. According to the BIS, fully two-thirds of international bank lending in the second half of 1980 was short-term, against only 50 percent short-term during the preceding two years. Latin America took $23.1 billion, 62 percent at a maturity of less than a year, and Asia took $6.2 billion, 77 percent at short term.

Judging by first-half 1981 lending rates, the lending explosion on the short-term side has kept up, if only because commercial banks have no choice but to refinance the interest due them from Third World borrowers who cannot pay it without borrowing more. IMF Director de Larosière's warning of a $100 billion payments deficit for these countries in 1981 is, in effect, a warning.

Making the best of a bad situation, the commercial banks themselves have insisted that the current rate of lending to refinance bad paper is no problem. "The ability and efficiency with which the Eurocurrency markets adapt to changing financial conditions can be just as impressive in times of seemingly little stress as during times of crisis," writes Chase economist Bluford Putnam in the July 20 issue of the bank's *International Finance* newsletter. "The imposition of credit controls in the United States in the spring of 1980 caused 'tight' monetary conditions in the classic sense, as some market participants were denied sources of credit. . . . But such tightness failed to carry over to the Euromarkets because such rationing of credit requires regulations that cannot be imposed on the Euromarkets."

The West German banks display no such optimism; in a recent pronouncement West Germany's Commerzbank, one of the big three, says that the Euromarkets "have reached the limit of expansion," warning that the private banks cannot continue handling the growing developing-sector deficit.

Former British central banker Lord Cromer, Italian central banker Giovanni Magnifico, and a former chief adviser to Prime Minister Harold Wilson, Lord Lever, are circulating a plan for an international mechanism among governments and central banks to handle potential crises of country or commercial-bank default in the Eurocurrency market, as a prelude to the creation of a "new international bank." The plan emerged publicly in articles by Lord Lever in the London *Times* July 15 and 16.

However, Federal Reserve officials warn that an open effort to install a crisis management mechanism with real operational powers might trigger an uncontrollable situation. The Catch-22 of central banking, an official said, is that if banks are told that everything is in control, they will go out of control. "Once there are written rules as to how a bank may draw on central bank resources, the banks are much more likely to engage in irresponsible lending practices," that is, get themselves deeper into the mess!

For that reason, the Fed concludes that there is an "overwhelming case" against a formal international crisis management setup. At present the monthly meetings of central bankers at the headquarters of the Bank for International Settlements in Basel are limited to discussions and suggestions, "where horror stories are put on the table."

However, under existing arrangements, the BIS, including the regulatory club, or "Cooke Committee," has no real operational powers or firm commitments for action—and the possibility always remains that one central bank could decide to break ranks. The Bundesbank is already considering separate exchange controls "to isolate West Germany from the worst effects of a dollar blowout," says a high-level Bundesbank source.

The story appears to be that central bankers talk a crisis better than they could manage one.

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