EIR burns Volcker on loan scam

Our exposé of Volcker's "soft currency" method of papering over the Ibero-American debt has had an effect.

A fight has begun in Washington over Federal Reserve Chairman Paul Volcker's plans to let the money-center banks take interest payments on their dollar debt, not in dollars, but in Brazilian cruzeiros, Mexican pesos, and other soft currencies.

Readers tell me that they have confronted senior Washington officials, including Volcker's number-two man, Fed governor Henry Wallich, and Comptroller of the Currency C. Todd Connover with *EIR*'s exposé. The response was "inadequate at best," as one put it.

"I asked the comptroller of the currency point blank at a Washington meeting at the end of February whether he was allowing the big banks to take interest payments in soft currencies and still account the loans as if they were performing well," one regional banker told me March 7. "He didn't have a good answer; he just turned bright red and was very quiet."

As we note in this week's International Credit column, under U.S. bank law, loans whose interest is not paid in dollars for more than 90 days must be declared "non-performing," and the bank must write off that interest income. Brazil is already 120 days in arrears, or $4 billion, on its interest bill. Argentina has over $3 billion in arrears, and total arrears on the continent will approach $10 billion March 31.

Some sort of decision will have to be made by the regulators by then, the date for their quarterly bank examination. The regulators will have to declare these loans performing or non-performing.

To deal with this, as *EIR* has reported for the past few weeks, Volcker, Wallich, and Connover had agreed to let the largest banks take interest payments in debtors' domestic currencies, and yet account these as "performing" assets.

Comptroller Connover, in a private letter to lawyers for Citibank, told them that "private and public sector Brazil debt" could be paid by "obligees on the loans meeting their financial obligations on those credits by paying cruzeiros" to the creditors. Governor Wallich told New York bank executives at a private meeting at Citibank on Feb. 15 that interest payments "in soft currencies" would be counted as dollar payments.

Citibank official William Rhodes and Manufacturers Hanover official Douglas McCouch have also briefed some of my regional bank readers on the plan.

But *EIR* has also learned that the controversy fueled by our exposé may have caused some in Washington to have second thoughts.

Confronted with *EIR*'s report by regional bankers at another Washington meeting the first week in March, Federal Reserve officials denied that they were accepting Brazilian and other soft currencies as valid interest payments. "Local currencies are being accepted for some Brazilian principal payments," one official from the Fed's Supervisory and Regulation section said, "but interest must be paid in full in U.S. dollars."

Policy will have to be clarified by March 31. One possibility is a "double standard," in which only the largest banks (which would be hit with unsustainable losses if loans are declared non-performing) will be allowed to use the soft-currency accounting scam. Smaller regional banks would not be allowed to do so. Given the regulators' "full discretion" and secrecy, it will be hard to prove such discrimination.

For years the regulators have required regional banks, although they are better run than the money-center giants, to hold a higher ratio of capital to loans than the latter.

A second possibility: The large banks and International Monetary Fund will quickly give cash to the accounts of Brazil and Argentina in order to bring dollar arrearages more up to date. Major creditors had planned to cut off such dollar extensions and amass debtor currencies, to buy out debtors' industrial and mineral assets. But in the glare of publicity, such debtor-currency accounts may become a liability.

Argentine sources now believe that the banks will have to lend them at least $1.1 billion by the end of March to reduce the country's $3 billion in interest arrears, or a substantial part of Argentina's $45 billion debt will have to be declared non-performing—i.e., they believe the regulators may back off from the Volcker plan to accept Argentine pesos.

After threatening to cancel its agreement with Brazil, the IMF is also suddenly now reported by Swiss sources to be about to grant Brazil over $1 billion in emergency funds.

A third, most remote possibility is a confrontation in which no new dollar funds are lent, and the regulators also disallow payment in soft currencies. Then we have an international banking crisis which will pull the plug on Ronald Reagan.