on the edges," a City journalist said. "A bit of everything. There is really no grand strategy behind all that, it's crisis management, hand to mouth. When the bailout comes, so many dollars will be printed that interest rates will fall, and the dollar will tumble—all the more that the United States is now a net debtor. In fact, the dollar has *already* been devalued since higher and higher interest rates are required to sustain it. And U.S. banks are in very bad shape: look up the Ponzi games being played by a certain major S&L in California, which is offsetting its losses only through cashing in huge fees on dubious operations. It cannot go on much longer."

'Insulate the City'

The danger for the banks, and the whole financial structure, has not remained unnoticed, and a great deal of work has been done in the City, at Whitehall, and at the Bank of England on how to "insulate" the City from the expected shocks in international finance. This is why an unprecedented spate of mergers, acquisitions, buyouts and so forth has hit the City in the last year, and has been accelerating constantly.

Brokers, stockjobbers, and other financial service units are being taken over in part or *in toto* by merchant banks, clearing banks, and insurance companies. "The capitalization of brokers and jobbers is low, too low to absorb heavy trouble if and when it comes—and there's plenty of that already," a broker said. A considerable regroupment is underway, which aims at consolidating and capitalizing a lesser number of financial units in order to mimimize the amount of rubble that will have to be cleared. The 8% loss of capitalization suffered in one day by the Midland Bank at the end of June, on account of its large Latin American exposure, has left a deep mark.

Despite the sober analytical acknowledgment of the reality and urgency of the debt and banking crisis, there is little sign that action will be taken or initiatives thought up and acted upon that would go beyond the "muddle-through" policy. At least, no such intent appeared in these various conversations.

'The debtors' cartel is now a reality'

The following is an interview with a prominent City of London merchant banker, who requested that his name be withheld from publication. The interview was conducted by our European Economics Editor Laurent Murawiec in London on June 28.

Q: How are banks doing in the present phase of the debt crisis?

A: A tremendous loss of liquidity is developing as banks find increasing holes on the asset side of their balance sheets, and the holes are going to have to be plugged. [Swiss National Bank director] Markus Lusser's proposal of a secondary market for discounted bank claims can't work. The capital structures of the banks cannot take it: How do you replace the lost liquidity? Selling an asset at a discount means that it is lost forever, which cuts the net worth of the bank, and therefore, its overall ability to lend, since the "gearing" is necessarily at a lower level. At a 25-50% discount on assets, it becomes untenable. No, emergency liquidity will have to be provided to the banks.

The debtors' cartel is a reality, from Cartagena onwards. Debtors will radicalize, and concessions will have to be made. Which brings about two problems for the banks: cash-flow and accounting.

Q: Creditor bankers have publicly been insisting that they would stick to a hard-line with the debtors, although. . .

A: Creditors are in a bind. U.S. banks stick to their idea that concessions mean loosening the IMF grip, and reducing the incentive for debtors to behave as good boys. Concessions mean loss of authority, and radicalization. But no concessions means a confrontation, in which the debtors can now fight—and perhaps win.

Central banks have all kinds of contingencies planned out, all based more or less on relaxing monetary targets—the line Fritz Leutwiler [outgoing chairman of the Swiss National Bank and Bank for International Settlements] expounded first in his *Die Zeit* interview in June.

Q: What about the numerous recent proposals for easing the debt burden while keeping the assets, interest capitalization, interest rate capping, and so forth?

A: Capitalization is not an option: on the one hand, it means making the debt eternal, through compound interest. On the other hand, it's just like lending new money, or adding new debt. Capping is not going to work: Who is going to cap how much, related to what, and on whose authority? If you cap interest rates, there is no incentive. Of course, no interest is really being paid at present, but it shows that this "solution" just brings us back to square one, where we are anyway. So, why move?

Q: What do you think could be done, then?

A: Well, some coordinated action between debtors and creditors, I think, with the U.S. taking the lead. If emergency liquidity is provided, and dollars printed en masse, bank stocks will fall dramatically, so will the stock markets, and interest will go down significantly. But banks must be enabled to keep on lending to the productive sectors, to save the world from terminal recession. The problem is to control the liquidity thus issued: it took $7.5 billion—officially—to save Conti Illinois alone! Bank stocks will collapse since the condition for the bailout will be that they pay no dividend at all for some while. Some banks will go belly up, though not many. The effect, overall, will be badly recessive.

Q: What of the debtors?
A: The first and last at this moment is that the debtors' cartel is a functioning entity, whether we like it or not, and believe me, a lot of us don't like it at all. But it's there.

What can happen to Latin America? Under moratorium or semi-moratorium conditions, some measure of growth will restart, with limiting factors: recession in the rest of the world, the depth of the Western recession which will now increasingly appear, especially in the U.S., in 1985, and little bank lending if any to the LDCs. They will need international institutional money and export credit from Western governments. Some internally-generated growth will still be there. But they'll have an export problem with growing protectionism.

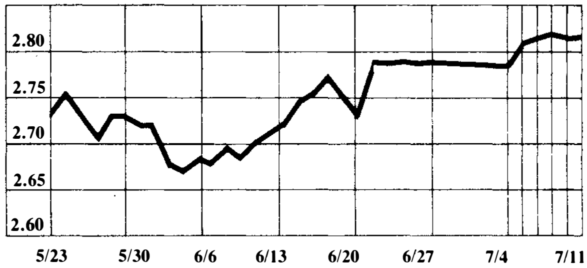
Overall, Cartagena has to be accepted, including the final declaration. But if there is some thought of doing that in some central banks, count on them to hush it up completely until they move.

Q: Are other "solutions" being envisioned? I read a piece in the *Financial Times* on the possibility of seizing the assets of debtor nations?
A: No, no, you can't do that. All the work has been done on this, believe me, it cannot be done, not seriously. The myth has been exploded. Most of the time, the debtor is a legally independent entity rather than a government. Debtors could deposit assets with the BIS, where they would be untouchable. Or with Swiss banks, which won't seize deposits in numbered accounts! Can you imagine a big Swiss bank seizing the personal account of Delfim Neto? And you can't go to a Brazilian court, for instance, and get a judgment against a Brazilian debtor, and get enforcement. Forget it.

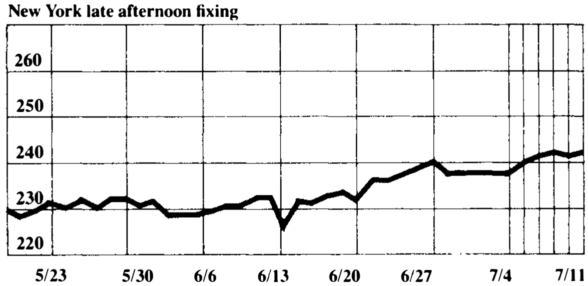
Q: What about the Kissinger-Leutwiler scheme of debt for equity?
A: Forget it, too. The [World Bank affiliated] International Financial Corporation has been talking to various countries on how to stimulate foreign equity investment there, including converting loans into equity. But first, you would have to offer a yield on equity higher than on debt, and second, to be able to repatriate the proceeds, have a hard-currency cash-return, and that is not a given at all. And it would be inflationary for the countries concerned. And then, which country really has a market in assets that would be big enough to cover part of the debt? Mexico, Brazil. You'll get shot at with rifles if you try. Forget it.

Currency Rates

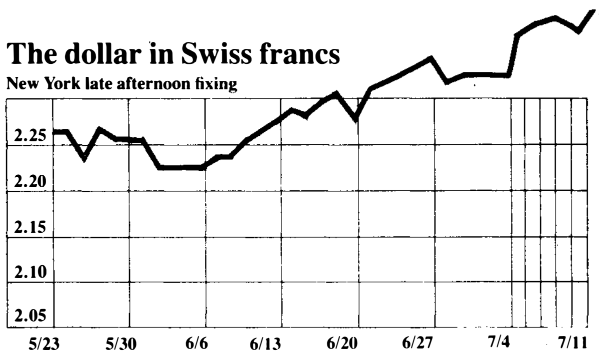
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing