including Malaysia, to amend their constitutions in relevant respects without informing them of FSIA's existence.

3. In recent negotiations arranging a large loan to Iran, Shearman and Sterling attorneys discussed the question of the "fuzzy"-ness of the language in the loan agreement which indicates that the loan is of a "commercial nature" (thereby subject to the FSIA). Shearman and Sterling attorneys, according to reliable sources, know that the loan is to be arranged through the Chase Manhattan Bank and may intend not to inform Chase that there is a possibility that Chase might not be able to seize Iranian assets in case of default...thereby crippling Chase to the comparative advantage of Citibank. The problem that confronts Shearman and Sterling, however, is that favorable immunity for Iran in this case might set a precedent unfavorable for Citibank in future loans to other nations, particularly Venezuela (upsetting manipulations 1. and 2.).

4. Sources also indicate that Shearman and Sterling has been involved in internal debate on the problem of whether the FSIA is sufficiently reliable to omit *explicit waivers* of immunity in loan agreements with other nations while at the same time not exposing Citibank Directors to liability to stockholders if the bank is unable to seize property under the FSIA as collateral. Two related problems apparently have been whether the debtor nation need be informed of the effects of the FSIA, particularly the "implicit" waiver provisions — i.e. "ignorance of the law is no excuse..." — and secondly whether demanding explicit waiver would, under the present political climate, result in a termination of the loan agreement because of the increasing nationalism of most Third World nations, and growing European resentment of Wall Street's attempt to impose an IMF austerity dictatorship.

5. Among these other intrigues, Shearman and Sterling attorneys have been in discussions with the Government of Zaire to encourage that nation to set up an "account" either in England or with the Bank for International Settlements for payment of the large debts owed to Citibank and other Wall Street banks. According to reliable sources, Shearman and Sterling is studying possible forms for the Zairean account that would not be subject to sovereign immunity, without informing the government that the account will be vulnerable. The sources indicate that Shearman and Sterling was in close contact with the British firm of Linklaters and Paines regarding British law on the matter, and the firm of Niederer, Kraft, and Frey, regarding immunity of foreign accounts at the Bank of International Settlements.

Europeans Take Control To Stabilize Their Currencies

FOREIGN EXCHANGE

In the wake of the Scandinavian devaluations within the European currency snake last weekend, foreign exchange markets looked notably stable and quiet this week, and are expected to remain so for some time. This reflects the firm control of the markets exercised by Western European central banks and finance ministries, who are keeping the situation stabilized until the fundamental questions of their relationship to the dollar and the Carter Administration, on the one hand, and gold and the transfer ruble on the other, have been resolved.

Defense of the Snake

On Friday, April 1, following a secret meeting of the monetary authorities of the "snake" countries, the Swedish krona was devalued 6 percent, while Denmark and Norway devalued 3 percent. Finland followed April 4 with a 6 percent devaluation. Swedish exports have weakened, labor negotiations had broken down, and the government was under attack for its heavy borrowing abroad; a top-level government official said privately that the devaluation was worked out as an alternative to formal acceptance of International Monetary Fund conditions demanded by some Swedish groups.

The devaluation was part of a general Swedish deflationary package including a 15 percent tax on non-housing construction and a 3 percent increase in the value-added tax. On April 3, at a speech in Oslo, West German Chancellor Helmut Schmidt expressed disapproval of devaluation and austerity as tools of economic policy; however, the dominant process is close collaboration — not without disputes — among the snake countries and other Western European nations on short-term stabilization measures.

The success of this approach was shown in the absence of a post-devaluation rush into the "strong" currencies, the deutschemark and the Swiss franc, which would have been unwelcome to West Germany and Switzerland for reasons of export pricing and inflation control. Such a rush had been expected when in early February Chase Manhattan planned a scenario for Scandinavian devaluations that would push up the mark through hot-money pressures and thus jeopardize the viable "width" of intra-snake parities. The weak would get weaker, the strong would be forced to meet the Carter Administration's demand that they revalue upward, and further chaos could then be fomented.

Instead, the dollar itself weakened somewhat across the board and, as the *Journal of Commerce* underscored at week's end, funds have been flowing into Britain and Italy. The paper's Zurich correspondent attributes Swiss moves in this direction to a desire to get "highest yields." It is true that the deliberate decreases in Euromark and EuroSwiss interest rates are designed to accentuate this motivation. However, there is also significant politically motivated petrodollar switching away from Eurodollar deposits into the United Kingdom and Italy.

While holding Euromark rates below the Eurodollar level, the West German banks have also supported the Danish crown in particular, which moved this week to its firmest rate ever within the snake, through new lending and bond underwriting. The West German, Swiss and other governments meanwhile stand poised for intervention in the markets to whatever degree necessary to defend the snake; traders at one leading British bank complained that there will be no room for speculation until the West German and Swiss banks decide to "move in" and supersede this control, since they are the only ones with enough clout to break it up. When they move, the question is whether it will be for or against the dollar.

Rising Yen

The most dynamic aspect of the markets has been the continued appreciation of the Japanese yen against the dollar, which abated toward the end of the week. It appears that Prime Minister Takeo Fukuda has made an agreement with the Carter Administration to let the yen rise to about 270 to the dollar, much to the unease of Japanese exporters. Up to now, the comparatively low rate of domestic inflation had permitted Japan's export prices to retain their advantage despite the yen's rise this year. But — as indicated by the 4 percent decline in seasonally adjusted export letters of credit issued in March — the export boom is slowing down. Forward rates in the Tokyo market are giving a premium to the dollar, not the yen, expressing an expectation that the export deceleration will pull down Japan's exchange rates.

Meanwhile, the head of the Bank of Japan, Teichiro Morinaga, crisply referred April 7 to a "speculative factor" driving up the yen-dollar rate out of correspondence to economic reality. Citibank's foreign exchange analysts had reported earlier this year that Tokyo dealers were involved in such speculation. Southeast Asian and Arab investors have also been moving into the yen recently.

Britain Bucks IMF

A key development regarding sterling this week was the United Kingdom's announcement that on April 14, foreign currency bonds will be issued to replace sterling held by foreign governments, central banks, and other official authorities abroad. The dumpable "sterling balances" had continued to possess a disruptive potential for the pound's standing, despite the stabilization achieved in recent months. The residual reserve status of the pound was a distinct burden on the United Kingdom. One billion of the £2 billion in official sterling balances will be converted into bonds with five-to-seven-year maturities bought with the official reserves and repaid 75 percent in dollars, the rest in yen, marks and Swiss francs.

The pound continued solid this week, partly because of this implementation announcement, and also because of the news of a $1.8 billion March increase in Bank of England reserves to a record $9.6 billion. Private borrowing declined last month, as corporations used prior credit lines obtained in the expectation that interest rates would rise. However, another quarter-percent cut was made this week in the minimum lending rate to 9.25 percent. An unnamed banker fumed in the April 8 *Journal of Commerce* that Britain was abandoning its IMF commitments to crimp credit, keep the pound's exchange rates "competitive," and continue real wage cuts. The British financial press is openly attacking IMF demands that the pound sink, and IMF economic warfare to enforce the demands would undoubtedly backfire.

In addition to the direct inflow of Swiss and Arab money, British corporations have begun to enter the Eurobond market; a new EMI issue is being quoted above par. The April 3 *London Sunday Times* characterized the situation as a victory of the "industrial" over "financial" approach expressed by government abandonment of currency manipulation as a focus of economic policy. Elements in both the Labour and Conservative Parties have made a postwar habit of citing the need to sacrifice industrial growth to bolster the pound, a claim losing credibility under current circumstances.

Italy Holds Steady

Italian authorities, complains an OECD report this week, are also cheating on their IMF commitments to austerity and credit restriction. Indeed, industrial production rose almost 10 percent in February; and at least some parts of the state-controlled sector seem suspiciously liquid, the OECD protests. The borrowing prospects of private industry "have greatly improved," according to the April 8 *Journal of Commerce*, which describes the "amazing resiliency" of Italian corporations despite Italy's having been placed on the IMF's "special mention list" to discourage private lending. One potentially destabilizing development is the collapse of the SGI real estate and construction conglomerate linked to financier Michel Sindona and the Banco di Roma, but nothing like a generalized banking crisis has come in sight. The lira actually strengthened against the dollar this week.

The French franc was unaffected by any significant side-effects of the Scandinavian devaluations. The Banque de France has engaged in light dollar buying to maintain the present level of the franc; some traders think that the market will tire of holding short positions against the franc, and the upward direction will increase.

Eurobond Markets Pick Up

Based on the differential between Eurobond yields and Eurocurrency deposit rates, and more deeply on some international investors' semi-political decisions to put funds into selective longer-term loans rather than Eurodollar rollovers, both the volume and the terms of Eurobond lending have improved for issuers. In this seller's market, coupons are being cut and prices are rising for both the dollar and Eurocurrency sectors. Bonds denominated in French francs are drawing interest, presumably from investors who have pulled out of the French stock market but retain confidence in the franc.

Most interesting is the deutschemark sector which saw only one new Euromark issue in February (for the $40 million Swedish state-sector holding company Statsfoeretag). Purchasers were said to be holding back for lack of upward pressure on the mark's exchange rates. In March, another Swedish government mark offering and a Norwegian loan, both in marks, were considered "indigestible" at month's end. However, the West German bond marketing supervisory committee approved a record 1.1 billion DM total of new Eurobond issues for April. The effect of many of these loans is West German assistance in forestalling cuts in European state projects to cover deficit financing, as exemplified by the Bayerische Vereinsbank handling of a private placement for the Elf-Norges French-Norwegian North Sea oil development venture.

A rather amusing footnote to the Eurobond picture was added April 6 when Deutsche Bank board chairman Wilfried Guth announced that part of the bank's capital expansion would be raised through a Eurodollar bond issue whose price would be calculated at the average market price of Deutsche shares 10 days before the issue is floated, and converted into dollars at the median exchange rate on the date of price resolution. This, said Guth, should enable the bank "to raise medium-term funds for refinancing of our group's dollar business at the most advantageous cost," since the dollar is bound to be pushed down by President Carter's "diffuse economic policy."

IMF Bailout Flops; Banking Crisis Looms For 2nd Quarter Of 1977

BANKING

Strident opposition from the U.S. Congress, Western Europe, and Japan has grounded plans for a $20-80 billion International Monetary Fund — Organization for Economic Cooperation and Development bailout of Third World and other debt owed primarily to the Rockefeller-dominated New York commercial banks. The impending flop forced one highly placed Chase Manhattan Bank official to admit this week that the banks may not be able to refinance an estimated $17 billion in Third World principal payments and an equivalent amount of interest that falls due during the second and third quarters of 1977.

Confidence in the New York banks so far has depended on the expected IMF takeover of part of the refinancing burden, and on the banks' facility at luring unsuspecting U.S. regional, European, and other foreign banks into assuming part of the bad debt via joint syndication loans with the New York banks.

Such confidence is now non-existent. At an April 7 press conference, Bank of Japan Governor Morinaga stated quite unequivocally that should the purpose of the proposed new IMF facility be to "replace the assets" of U.S. international banks, it would not be acceptable to Japan. Japanese banks recently refused to participate in two large syndication loans totalling $400 million for the Brazilian state oil company, Petrobras, which were managed by the Chase Manhattan and Wells Fargo banks, because the Japanese considered the loans to be pure roll-overs of existing debt and therefore unsound.

Anti-bailout sentiment has also been expressed by the leading Western European press, including the conservative West German *Die Welt*, which warned April 6 that "not only have debt moratoria occurred in the last several years — their frequency threatens to increase as well." On the same day, the Italian daily *Corriere della Sera* revealed that "general debt moratorium has been advanced in various international meetings, and this portends the collapse" of the banking system. *Corriere* correspondent Marco Borsa further noted that support for the proposed IMF expansion was limited mainly to the U.S. international banks which have a heavy stake in Third World loans.

A top British banker commented wryly in an interview: "If you really want to bankrupt the New York banks, damn, it is easy: Just get one or a couple of Third World countries to default."

According to Japanese banking sources, the OPEC countries — which have been requested by IMF managing director Johannes Witteveen to supply the bulk of the additional funds — are extremely reluctant to do so and have decided to submit a counter-proposal for IMF "reorganization". The Japanese Finance Ministry has delayed the unveiling of its own reorganization plan in order to coordinate it with OPEC.

Bergsten: All Roses and Whine

One of the lone voices defending the integrity of the New York banks this week was C. Fred Bergsten, Assistant Treasury Secretary, who told the House Banking Subcommittee on Financial Institutions on April 5: "We reject the view that the international lending activities of American banks are posing grave risks to the American economy or banking system....We can find no adverse effects on our own economy, the soundness of our banking system, the availability of credit for domestic purposes, or the entire world economy."

In his next breath, however, according to a report in the April 5 *Journal of Commerce*, Bergsten went on to specify the need for the IMF and OECD to get a total of $83 billion from the oil-producing and industrialized nations to help "backstop" the private banking system. This would include:

— A $15 billion special IMF facility, known in Washington as the "Witteveen facility" which would solicit loans to the IMF from countries with "surplus" reserves such as Japan, West Germany, and the OPEC states. IMF Director Johannes Witteveen is currently shuttling from Riyad, Saudi Arabia, to Tokyo discussing this plan.

— A fresh $43 billion increase in general IMF member quotas (contributions as members to the IMF.) This sum would be a "Seventh" or new quota increase, above and beyond the $11 billion "Sixth quota review" increase