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Interbank market dangers rise

Despite talk of calming on the international markets, the temperature on the interbank market is still 106°.

The benchmark rate for the international money markets, the six-month LIBOR (London Interbank Offering Rate), was a shade below 13 percent Sept. 21, almost 2 percent higher than the comparable six-month Certificate of Deposit rate in New York. This highly unusual spread between what are, after all, comparable borrowing rates by major banks, is a signal that a crisis of confidence on the interbank market remains in sway, two months after the failure of the Luxemburg subsidiary of Italy's Banco Ambrosiano marked the first big interbank market failure since the 1974 Herstatt events.

However, even the higher, interbank market rate is less than a true measure of banks' cost of funds, since the majority of banks are paying 1 to 2 percent above LIBOR for money at the moment under a "tiering" system that has emerged in the past eight weeks. On average, the actual cost of funds is at least 1 percent above LIBOR, or roughly 14 percent, acting as the "reference rate" for a few, top American banks.

What has happened to the lower Certificate of Deposit rate, meanwhile, is that it is rapidly losing significance as a measure of banks' cost of funds. After the Drysdale, Lombard-Wall, Penn Square, Braniff, GHR, and other recent failures—let alone the continuing fear of Mexican default—several top American banks dare not issue CD's. Chase Manhattan, the nation's number three commercial bank, has not only ceased issuing CD's during the past month; it is buying its outstanding CD's from the market to support their price, in order to prevent them from trading at an embarrassing premium. As money market fund managers told the *New York Times* Sept. 21, "The fear is that the money fund's investors might withdraw their money if they see that the fund is holding a CD of a bank that had recently encountered problems."

Chase is funding these purchases into its own CD's by borrowing at or near LIBOR on the Euromarkets (where interbank transactions are private between banks), that is, at 13 percent or higher. Its cost of funds have little to do with either the 10 percent-plus Federal Funds rate or the 11 percent-plus CD rate. The margin between LIBOR and the present 13½ percent prime rate, which banks are charging their top customers, is pretty thin. This is creating pressure for a prime rate change—in the upwards, as opposed to downwards direction.

For developing-country borrowers also there has been no interest rate decline. The cost of funds for these borrowers is now at 14 percent (average interbank cost) plus a 1 to 2 percent spread, that is, 15 to 16 percent. This is hardly less than the 17 to 18 percent charge of a few months ago, particularly since raw materials prices, a chief source of foreign exchange earnings in the Third World, have continued to fall.

Since January, Brazil, the second-largest borrower worldwide, has been paying a 2-2.5 percent spread on new loans. Banks are now refusing to refinance the debts of many Third World countries, such as Venezuela, unless they agree to come up to this Brazilian level.

In effect, the banks, across the board, are trying as much as possible, to dump interbank market pressures onto major sovereign borrowers. Leading banks are also poised for a Darwinian showdown for "survival of the fittest." American banks, traditional funders of foreign banks on the Eurodollar market, are attempting to wind down their positions to banks from other "industrialized" countries, again raising charges on loans to do so. French and Canadian banks, for example, have been told by their U.S. counterparts that they have hit their "borrowing limit" in absolute terms. The mounting pressure on non-U.S. banks to repay dollar assets had turned into a major source of weakness for European currencies, points out economist Ronald Liesching of Chase Manhattan Bank, since banks must convert local deposits into dollars in order to repay their dollar-denominated loans.

In sum, the effective cost of funds for all borrowers, domestic and foreign, is still above 15 percent, despite what is widely being heralded as an interest rate drop which is supposed to spur a "recovery." Specifically, this lingering effective high rate works out to be 7 to 8 percentage points above the rate at which corporations or exporters may increase prices in order to compensate for borrowing costs. Due to the global depression of industry and output growth, price rises on this scale are practically speaking excluded. The 4 percent drop in durable goods orders in the United States in August is one such indication that a rise either in volume or prices in international trade to finance borrowing costs is nearly impossible to engineer in a depression.

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