Banking by William Engdahl

Who's the most off-balance-sheet?

Euromoney Magazine *and other sources point to the big New York money-center institutions.*

EIR is no longer the only place you can read about the impending financial crash of 1986, or the very real possibility that the brunt of the crash will hit the U.S. banking system.

London's *Euromoney Magazine,* the glossy house organ of the Eurodollar market, warned of a financial crash in its February 1986 editorial, noting:

"Last year, trading in foreign currency futures in the United States increased by more than 70%. From a standing start in 1982, more than 20 million equity index futures contracts changed hands last year. . . . Market crashes are usually preceded by a sharp increase in the numbers of buys and sells. Trading for the sake of trading expands far beyond the volume necessary to make a liquid market. Towards the end, it is also conducted via increasingly complex mechanisms and arrangements, usually involving a high degree of leverage. In plain language, everything overheats.

"The numbers that are most disturbing are those measuring world trade. It grew only a hair more than 3% last year and likely will be no better in 1986. . . . Since the purpose of finance is to facilitate underlying trade and economic growth, our question is this: Why is activity in the securities markets ballooning when the real world of making and exporting . . . is almost static? We hope the answer is not what we think it is."

Now, the same magazine has undertaken a somber assessment of how deeply the commercial banks have dug themselves into a financial hole. They have compiled a listing of world banking system exposures to rapidly growing "off-balance-sheet" lending. A forthcoming report shows that the banks most exposed to off-balance-sheet lending risks are the major New York money-center banks, headed by Citibank and including Chase Manhattan and others.

Next comes a group of Japanese banks followed by two French and at least two British clearing-house banks.

In March, the Bank for International Settlements sounded the alarm over the uncontrolled growth of such lending, which allows banks in many countries to avoid legal reserve-margin requirements and improve their book profits. The loans are outside the review of bank regulatory authorities.

Similar studies are under way at the Swiss banks' research organization. An economist at a leading Swiss banking research institute warns, "Dangers from banks' off-balance-sheet exposure is far more serious than even the LDC debt. At least LDC debt is the focus of major risk-assessment by the banks, by IMF, by governments. But banks have entered into 5-10 year obligations so sophisticated that even banks don't know where the problems are. They have no risk-evaluation policy on these exposures."

One particularly nasty feature of the "off-balance-sheet operations" is that they have permitted banks to sell off their best-performing loans in the form of securities, raising money in the short-term, while leaving a higher proportion of bad loans in their portfolios.

In particular, the New York banks have sold off their most dependable loans. According to London financial community sources, there is growing alarm over the process of "securitization" and growth of "off-balance-sheet" lending through which, increasingly since the outbreak of the debt crisis in 1982, major money-center banks have technically improved book profits to conceal loan losses.

"Banks are expanding off-balance-sheet lending at phenomenal rates," a senior partner of a London brokerage house said. "The hottest thing now is 'Euro commercial paper'—7- to 365-day paper. Through this, the banks shift loans off their books into other hands. In fact, this has meant that banks are getting the loans to their best corporate customers off their books and increasing profit through high-margin but far riskier loans. This will aggravate any problem which results if we have a collapse of confidence."

In addition, French bank involvement in off-balance-sheet lending has become a major concern of the French authorities. According to sources close to the Bank of France, the extent of French banks' exposure to off-balance-sheet liabilities is a major obstacle to the privatization plans of the Chirac government.

"The auditors are having a difficult time determining accurately what the financial shape of the banks actually is," he admitted.

London financial analysts report that French banks have resorted to extensive off-balance-sheet lending to cover extreme losses in domestic and foreign loans—especially in Nigeria and other parts of Africa."