INTERNATIONAL MONEY AND BANKING ISSUES

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An analysis of world financial conditions must start with an examination of world economic conditions. We expect, through 1984, economic conditions that include:

- Slow economic recovery in most of the industrialized world
- Very slight increases in world trade
- Some further rise in protectionism
- Continuing depressed conditions in most of the less developed world
- Stable oil prices.

One aspect of the world financial picture concerns exchange rates. The most important currency is the dollar. On a trade weighted basis, the dollar is likely to remain essentially at its current levels throughout all of 1984. Much of our trade is with Canada and we expect the Canadian/U.S. exchange rate to remain around current levels, primarily because economic conditions in both countries are now changing in essentially consistent ways and existing conditions in both countries are accurately reflected in exchange rates.

A substantial amount of U.S. trade is with Latin America and, for the most part, these currencies are likely to have further declines in value against the dollar.

A further considerable portion of U.S. trade is with Europe and the Far East. In general, their economies will be rising next year and their inflation rates and interest rates will be quite similar to our own. Because of a major current account deficit in the U.S., however, we may see a slight weakening in the value of the dollar relative to both the mark and the yen.

In general, it will continue to be difficult to sell in foreign markets because our products remain expensive in local currency terms. The situation will not deteriorate in 1984 — that is the dollar is not likely to become stronger than it has been in 1983 — but the situation will not materially improve either. In some cases, such as in Latin America, restrictions on imports may actually reduce U.S. exports to those countries.

At the same time, we should look forward to even more intensive competition from overseas producers. In part, this is because of our continuing economic recovery and in part because of their ability to undercut our prices through low exchange rates.

In examining financial condition, we should first look at financial markets in this country because our financial markets are the dominant ones in the world. Even though these markets are dominated by domestic factors, our markets represent the pivot point for world financial conditions.

We see U.S. interest rates in a slight, very modest, decline into at least the spring of next year. At most, interest rates will be some 200 basis points lower than at present. Through the balance of 1984, U.S. interest rates are likely to be rising, although slowly. Thus, we should end 1984 with interest rates about 75 to 100 basis points below present levels. In effect, fluctuations within a trading range that is essentially horizontal.

We must include the U.S. equities market in an analysis of international financial conditions. Again the U.S. equity market is the largest such market in the world and tends to dominate financial conditions worldwide. We are very bullish on the equities markets. In our judgment, the stock market has entered a long-term bullish movement that will extend for many years and take the Dow into the 1400 to 1600 range next year.

Interest rates in international dollar denominated markets are likely to behave much as interest rates in the U.S. We do not believe that foreign federal banks can, for any sustained period of time, direct interest rates away from those dictated by arbitrage with U.S. markets. Thus, our forecasts for foreign interest rates both in Eurodollar and Eurobond markets and in the domestic markets, all major trading partners, are likely to behave in sympathy with domestic rates.

Let me now turn to some world financial conditions associated with these forecasts. First, and by all odds the most dominant conclusion, is that U.S. financial markets will continue to be a powerful magnet attracting funds from the rest of the world. In addition to the high interest rates and the strong value of the dollar, foreign funds are attracted to the U.S. by a stable government environment, the largest and most liquid markets in the world, the freest market conditions in the world, and one of the most rapidly growing economies in the world.

These circumstances work hand in glove with the forecasts to support the forecasts. There will be a strong dollar in 1984, despite a major trading deficit which pumps dollars into foreign hands, because foreigners wish to obtain dollars in order to invest in the U.S. Interest rates remain high in the U.S., and therefore attractive to investors, in major part because of the growth in the U.S. economy and the demands for funds which that growth requires.

You probably want to discuss bank loans to less developed debtor countries and the dangers that those imply for the international financial system. Let me make a series of points and then elaborate.

- The financial and popular press has been, quite consistently, about six months behind the times in writing on this subject. The reason is that the most serious negotiations concerning these outstanding loans is occurring behind closed doors. Their bankers typically do not confide in the press. This means that people generally are worrying about these matters often times well after the problems have been addressed.
- A number of economic developments have occurred over the last two years which have substantially eased the stresses associated with the heavy debt burdens of some less developed countries. These developments include: first, the fact that the U.S. economy has been recovering and, therefore its demands for goods and services produced elsewhere in the world, including especially some of the depressed debtor nations, has been increasing. Second, interest rates have come down sharply during the last two years and that has eased the servicing required of the less developed countries. Third, most of the outstanding loans of the depressed debtor nations have been rescheduled and stretched out so as to ease the burdens on these countries.
- It is equally important to stress some things that have not happened over the last two years. We have not had a collapse in the world financial system. We have not had a single formal default or moratorium on outstanding debt. Indeed surprisingly, we have not had a financial crisis at, or commensurate with, the prices associated in the past with a Chrysler or a Washington Public Power Supply System (WPPSS). This is important because the longer that time goes on without such difficulties, the more likely the possibility there will be no such crises.
- I can tell you some things that have occurred behind the scenes that are, to a banker, extraordinarily impressive. First, the world bankers who lend in international markets have drawn together and worked as a consolidated group on each of these loan situations with virtually no deflections or dropouts or scurrying to cover individual positions. Second, the world's major federal banks have worked in concerted effort with the leaders and have been exceptionally supportive. Third, the world international financial agencies have also been supportive to whatever degree they could be. There seems little likelihood that any of these conditions will change and that becomes a further part of supportive evidence concerning the viability of the system in 1984.

- It is a striking fact that everyone of the 19 depressed debtor countries that we monitor has taken some steps to tighten their own belts. These steps have involved reducing standards of living in countries where standards of living are already exceptionally low. In other words, each of these governments has taken politically difficult steps in order to ensure the continuing viability of an international financial system of which they are a part.

Therefore, we can look to 1984 with some measure of increased confidence in the continuing viability of an international system with which we are all familiar. I do not see any likelihood of a collapse in the international financial system. In terms of the individual banks that are participants in these international markets, each will not earn as much income as they had expected to when they made the initial loans. But those losses are not of a size and magnitude which should cause concern about the collapse of any major U.S. bank.

The picture I have painted is more favorable than that given the public by the press. But all is not rosy. Of the 19 countries which we monitor, a few — five or six — do not seem to be improving and may indeed be showing economic deterioration. I wish I could identify those five or six to you, but I cannot because I do not know for sure who they are.

Here then is our forecast concerning these depressed debtor countries. Most are slowly coming out of the deep financial holes they are in. These countries should not cause greater difficulties, indeed most will be of lesser concern in 1984 in comparison to prior years. But a few countries will have to return to the financial markets of the world for increased support in 1984. These are countries that are continuing to experience deteriorating financial conditions. I do not know how their problems will be resolved. But however the financial accommodations are worked out, the elements will not drastically change, nor indeed even significantly modify the ongoing operations of the world financial system. That, I believe, is the most valuable message I can bring to you today.