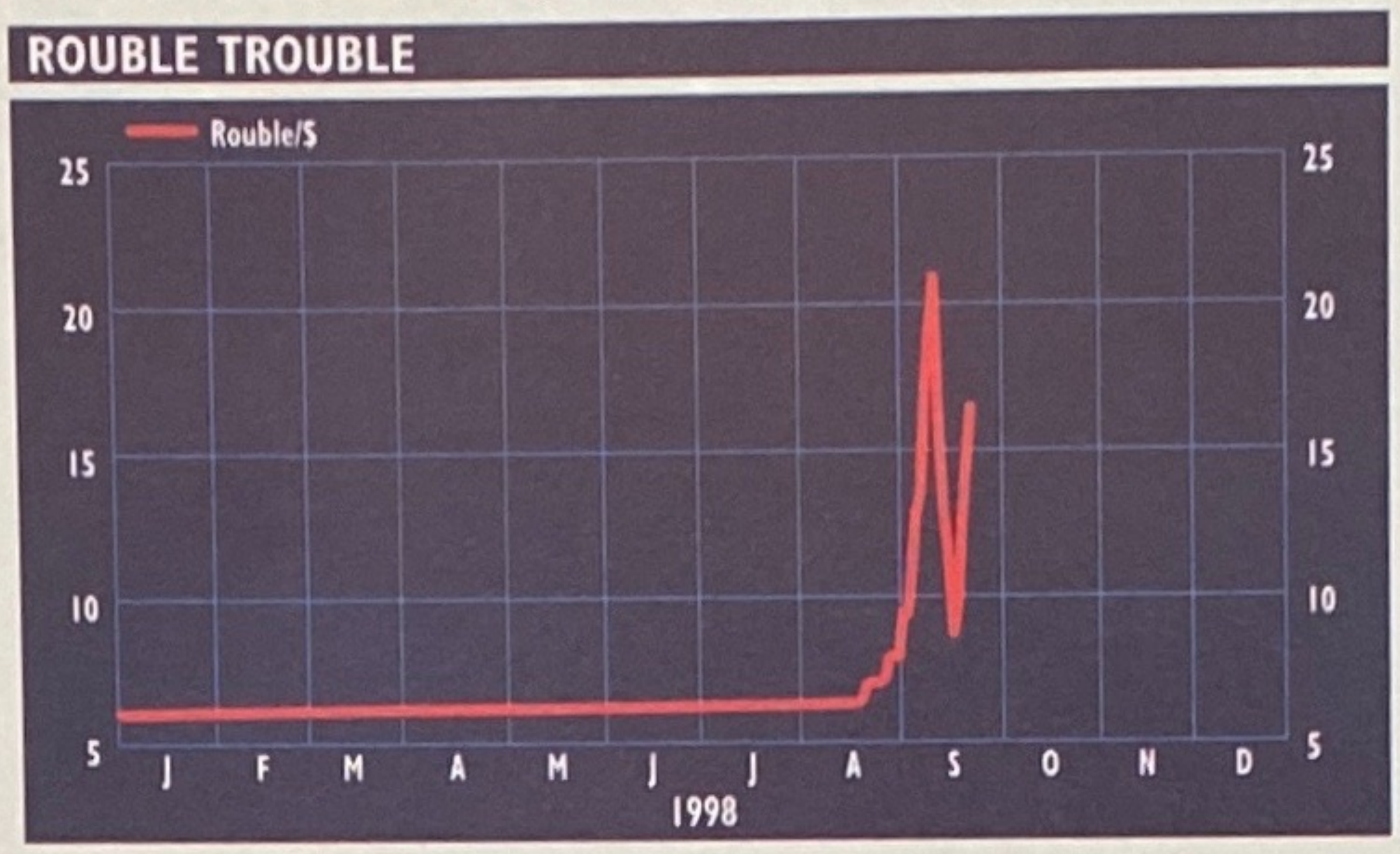
The banks' real roulette game isn't Russian

It's little surprise that Russia has run into the economic buffers, says Gerard Lyons. But that country's problems are nothing compared to the credit crunch awaiting lenders to Latin America.

First it was Thailand, then it was Indonesia, followed by South Korea, Japan and now Russia. This improbable list of countries could soon be joined by Brazil. All have one thing in common: during the last year they have been the trigger for renewed anxiety on the world's financial markets, causing mayhem well beyond their borders.



In the case of Japan one can understand why the rest of the world is worried. After all, Japan is the world's largest saver and its second-largest economy. Yet looking at some of the other countries *in isolation* it is hard to imagine why everyone is so worried. This is particularly so with Russia.

Russia may have once been one of the world's two superpowers but that seems a lifetime ago. Now Russia is a small part of the global economy and, even within Europe, its importance has dwindled. Countries in central and eastern Europe which were once satellites of the old Soviet empire now look to the west for their economic ties; only one-fiftieth of Germany's exports now go to Russia.

Russia's dismal economic performance in recent years – in which it has contracted and the rouble weakened – has continued to diminish its economic importance. Of course, Russia's military stockpile is a concern and it is a strategically important country with a large population, but its economic impact on the rest of the world is not great.

Yet Russia mattered this summer because it highlighted the extent to which problems from Asia had spread around the globe. It was like the last straw that broke the camel's back. It provided another shock to western stockmarkets, which had been discounting continued healthy economic performance and which were thus vulnerable to further poor news.

It is not a surprise that Russia has been caught up in the fall-out from Asia. When Asia's crisis broke, the region was expected by many to carry on enjoying economic success. It did not, and thus its fall from grace has had a big negative impact.

International banks had lent heavily to Asia and are now nursing sizeable bad loans. Asia was the fastest growing region of the world economy. The aftermath has been weak growth throughout the region, as firms and people pay off debt, banks cease to lend and bankruptcies and unemployment soar. Asia's slump has removed an important world market for exporters around the world. Inward investment into Britain has suffered.

But Asian firms are now exporting their way out of trouble. As over one-quarter of world exports come from there, cheaper goods are flooding western markets.

Asia's problems have had a significant impact on emerging and commodity exporting economies. Prior to last year, Asia was a large importer of commodities and thus the slump in Asia has triggered a collapse in commodity prices. Whilst this has been good for global inflation it has been bad for third world producers, whose export earnings have suffered.

Moreover, Asia's problems were exacerbated by a financial panic, which has since spread to emerging economies in Latin America and eastern Europe, leaving them vulnerable to western investors repatriating capital.

It is therefore hardly surprising that problems from Asia have affected the rest of the world, including Russia. Financial markets have been worried about the exposure of the banking sector to problems in Russia. Yet the scale of lending to Russia has not been as great as the amounts lent elsewhere, especially to Asia or Latin America. Indeed, the next stage of the global contagion problem means attention needs to be focussed on Latin America.

There are two ways to measure banks' exposure around the world: quarterly locational intentional banking statistics, making it possible to estimate cross-border flows of funds; and semi-annual consolidated international banking statistics. The latest semi-annual banking statistics from the Bank for International Settlements show that at the end of 1997 the total amount of lending to eastern Europe, including Russia, was $123bn compared with $283bn to Latin America. Just over 80% of the lending to eastern Europe was from European banks. Yet, contrary to popular perception, the bulk of lending to Latin America was also from European banks, not American.

European banks accounted for 61.8% of lending to Latin America, while North American banks accounted for 26.4% and Japanese banks 5.2%.

With growth and demand in Europe weak and with low returns in traditional business areas, European banks have clearly gone in search of profitable lending opportunities overseas. Some of this European lending has mirrored the operations of large European firms but this does not explain all of this growth in lending. In Asia, European banks also lent heavily to local private firms and they have probably done the same in Latin America. This points to further significant problems ahead for European banks.

US banks have lent to Latin America, but they have remembered the experience of the early eighties and, with a buoyant domestic lending market at home, they have not been as aggressive as others. (But note that earlier this summer the Federal Reserve Board warned US banks about their lax lending at home.)

The statistics for international bank lending outside the area of the 24 major economies (as measured by the total claims outstanding at the end of 1997) show the German banks are most heavily exposed. They account for 17% of all international claims. This compares with 11% by French banks, 8% by UK banks, 15% for the Japanese and 11% for the Americans.

So as the crisis from Asia spreads this will trigger additional concerns for international banks, who will become cautious in their lending behaviour. A global credit crunch becomes a risk, adding to the problems for the world economy and providing another reason for global interest rates to remain low. ●

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