

Full-Blown Dollar Crisis Emerging

FOREIGN EXCHANGE

The downward stagger of the dollar last week at times reached historic and near-historic lows vis-a-vis the yen and deutschemark respectively. The currency crisis is taking on a life of its own as a free-for-all with a basically defensive character on every side.

U.S. Treasury Secretary Blumenthal continued to assert publicly that he is satisfied with the dollar's ongoing depreciation and does not intend to take measures to arrest it. Elements in the Federal Reserve — which intervened July 8 when the dollar decline became really precipitous — are more vigilant about the possibilities of a panic.

However, as the West German business daily *Han-delsblatt* underscored last week, the Fed lacks sufficient reserves of currencies like the deutschemark and Swiss franc to sell them for dollars at conjunctures when large dollar purchases are needed to hold up the U.S. rate. The Fed finds it unseemly to buy its own currency, and borrow others' to do so. Consequently Washington has relied on other central banks to perform support operations, at a rate of \$250 million a day on the average during 1976, when the markets were far calmer than today. This strain on reserves can become acute during the kind of full-blown destabilizations that have not yet occurred.

Whatever its preferences, for the time being the Fed has bowed to Blumenthal's let-'er-rip posture, merely begging the Europeans to temper the dollar devaluation. Blumenthal and a number of New York banking strategists are moving up the timetable for an austerity depreciation pummeling of the weaker northern and southern European countries to smooth out the dollar's decline and, above all, make a concerted European counter-policy effectively impossible. Washington expects Europe and Japan to swallow U.S.-dictated monetary adjustments as they did in 1971-73.

Apart from Blumenthal's bromides — which increasingly resemble the bunker pledges of total victory uttered by Admiral Donitz as Allied troops moved in — all factions of the New York banking community now openly recognize the perils of the dollar slide. "The dollar is finished as a major currency," said a Rothschild-linked observer this week. The Rockefellers' Citibank sees "no current bottom to the dollar. It's like Catch-22: the lower it gets, the lower it goes. There is no confidence in the dollar." One Bankers Trust executive had just returned from Europe, where "everybody was asking me what's happened to the dollar and they were moving out of it. No one wants to hold dollars. They're going into D-marks, Swiss francs...Yeah, I know the problem of you have to end up holding dollars (as reserves), but no one wants them. The trade deficit is really a problem." The trade deficit, be it noted, is merely one expression of those bank's debtors' inability

— like Mexico — to maintain their imports from the U.S. The downturn in commodity and stock prices meanwhile reciprocally reinforces dollar weakness.

On the West German end, the monetary authorities saw the mark approaching its historic high of 2.23 to the dollar on July 11 — even though in principle the imminent devaluation of the Spanish peseta might have been taken as a testimony to the "aura of power" of the International Monetary Fund's policies, and thus have strengthened the dollar. The central banks of Italy, Holland, and France had to intervene to prevent their currencies from appreciating too sharply against the dollar.

This in turn posed a problem for West Germany, and a short-term response on July 14. The problem is the mark's tendency to stick up like a lonely thumb. France and other key trading partners rightly expect damage to their export competitiveness from appreciation of their currencies, while their import demand will remain too low to offer sufficient compensatory advantages from cheaper foreign purchases. They are therefore loath to move with the mark, despite their interim capacity to do so. Thus West Germany faces a solitary upvaluation which, although the effect on its specialized exports is probably marginal, puts intolerable strains on the joint-float European "snake" and brings an inflationary inrush of "hot money," at the same time that real economic activity is fearfully slacking.

Accordingly, on July 14 the Bundesbank lowered the Lombard rate (the central bank repurchase rate, comparable to the U.S. Federal funds rate) by half a point to 4 percent, pulling down the mark's spot and forward purchase parities and deposit interest rates as well. Observers thought this move, which occurred in coordination with Swiss monetary authorities, was not forceful enough, short of a bank rate cut, to hold down the mark. Bundesbank president Otmar Emminger, noted for his servility to the U.S. Treasury, was obliged to hold a press conference the same day emphasizing that the Lombard cut was due to "the explosive erosion" of the dollar and suggesting that the West Germans do not want to see the mark much higher than 2.29 to the dollar. The net effect of the Bundesbank's ploy was to prop the dollar (which again was slightly weaker July 15 across the board) and give the mark a little breathing room.

Following the Japanese elections, the Bank of Japan was expected to return to its unpopular pledge not to intervene to keep yen appreciation from devastating Japanese exports. Last week, however, this abstention was not strictly maintained. More important, the Japanese press began to spell out the view that the issue is not dollar-yen parities, but what they describe as a general crisis of the dollar comparable to the 1971 collapse. The prestigious *Asahi Evening News* of Tokyo called for genuine solutions to the global economic and monetary crisis, tacitly sweeping past the fears of Japanese industrialists that if they do not accept Blumenthal's upward push on the yen, the U.S. will slam them with drastic protectionist measures. The degree of

Washington's push may be measured by a U.S. Embassy survey concluding that a yen rate of 250 to the dollar is required to drive Japanese export prices to a level where U.S. manufactures can compete with Japan; yet in fact, Japanese exporters cannot live with a yen rate much above 262 to the dollar! The *Asahi* slyly noted that if the dollar crisis continues, Japanese government sources say they may feel compelled to ask Washington to do something about the mammoth U.S. trade deficit. The Japanese press has also made a point of reporting that Arab investors are moving out of dollar holdings into mark, yen and Swiss denominated ones.

This is small comfort to the French and British, for New York and Washington strategists, as everyone from Manufacturers Hanover and Bank of America to Lloyds of London agrees, are counting on mopping up sterling and the franc after deutschemark appreciation has destabilized the "snake" currencies. The markets are already primed for such a move, with the news that the French trade deficit moved from .444 million French francs in May to a shocking 2.3 billion in June, while industrial production continues to stagnate. Some U.S. bankers are actually counting on capital flight from France to help boost the dollar.

In Britain, the Callaghan government is trying to fend off the wolves by slashing appropriations for nationalized industry, insisting on a 10 percent ceiling on wage hikes (with inflation at 17 percent a year) and threatening that any corporation attempting to reach a higher wage accommodation with its work force will be penalized with loss of government contracts. This butchery against Britain's two key assets, the expansive potential of its nationalized industries and its skilled work force, cannot be compensated for by any amount of North Sea oil revenue. French Premier Raymond Barre has re-launched an equivalent incomes policy. Moreover, far from forestalling a threat to the franc and sterling, this will only encourage further assaults.

West German policymakers are proclaiming a dollar crisis but it remains to be seen what they will do to salvage their trading partners. The West German

newspaper of record, the *Frankfurter Allgemeine Zeitung*, attributed the dollar slide to the anticipated \$24 billion U.S. trade deficit in an article July 13, adding that Blumenthal's statements about the desirability of dollar depreciation represent "an incitement for dollar holders to switch to D-marks." Bundesbank officials specify smugly that the current dollar selling is not a normal speculative reflex but "a restructuring of currency deposit ratios," that is to say, a sizeable shift of longer-term assets out of the dollar. This shift is clearly welcome to West Germany and Switzerland, but no one pretends that it can stabilize the international monetary situation. One proposal from Bundesbank circles this week was an official reserve status for the mark; Brookings Institution Fellow Lawrence Krause told the *Asahi Evening News* two weeks ago that both the mark and yen should become reserve currencies. In the absence of a remedy for the underlying weakness of the dollar, and the dollar-debt overhang, this would simply lock West Germany, Japan, and everyone else further into the mess, as shown, *mutatis mutandis*, by the buffer experience of sterling over the past decades.

Dealers expected the dollar slide to continue in the coming week, with only temporary alleviation from the Bundesbank's Lombard drop and aggravation from the bank of England's dollar buying. If a terminal crunch were anticipated, however, a level of scuttling to sell dollars short would have been apparent, as has not been thus far. And the price of gold would be shooting beyond its present \$143-45 range as investors of all sizes hedged against a dollar collapse.

The peseta devaluation is only the most obvious case in point of a country left to the mercy of the IMF without sufficient backup from its European partners. After the 20 percent devaluation July 13 (technically speaking, an agreement to let the currency sink to that level), the OECD is demanding a further 20 percent devaluation in the near future. Sweden is under increasing pressure to do the same as industrial production drops, the stock market sags, and key banking figures publicly accept the IMF imperative.

The Pie Is Shrinking Fast

BUSINESS OUTLOOK

If there are any lingering doubts that the world economy is now a "shrinking pie," the following review of the present status of the U.S. economic "recovery" should dispel them.

Though the government's hallowed economic statistics hardly reflect the real state of decay of the U.S. economy, even they are signalling the onset of a new depression. Seventy percent of first quarter spending by businesses on new equipment was accounted for by purchases of new autos and trucks for business use! And

equipment accounted for the bulk of "plant and equipment" spending.

Shipments of factory durable goods are falling faster than orders because existing capacity is too decrepit to keep up even with the low level of orders.

Or take the lockout in the copper industry. World demand for copper from the electrical and other copper-consuming industries has been in a slump for four years running. World copper stocks are estimated at around two million tons — more than double the usual amount — and prices are below the cost of production.

While the copper workers went out on strike early this month, the New York financial networks who control the copper industry were making plans to triage the "uncompetitive" U.S. industry in favor of cheaper