

postponing the day of default, at the cost of a bigger default when it comes. . . .

The current account of these countries would have recovered smartly if the developed world had not slid into recession two years ago. . . . After the severe austerity programmes in these countries have been imposed, if there is a reasonable recovery in the West, the borrowers will quickly return to a sound position; but if stagflation continues, they will make no progress at all. . . .

Financial strain is not a symptom of recession, but the fundamental cause; our malaise is financial. The austerity programmes adopted by Third World borrowers will depress world demand by \$17bn this year, according to the OECD. Similar austerity imposed by overstretched commercial borrowers will have a bigger effect, because their debts are bigger. Capital formation in the U.S., for example, is 9 per cent down. . . .

The much discussed credit contraction, which all the pragmatic arm-twisting in the banking world at present is supposed to prevent, was already a fact before the bankers took fright. For the most dynamic developing countries, the interest burden caught up with the flow of new capital two years ago; the much-criticized "explosion" of lending has made virtually no new resources available to them as a group, and the new programme implies rapid net repayment of debt. . . .

The real problem is to arrange finance on manageable terms, and unless we are quickly able to resolve our policy crisis in the West—an unlikely outcome, according to the participants at Ditchley—this must mean a break from market-related money interest rates. The British Government has made this break with its indexed gilts (and thereby reduced money rates on conventional long-term borrowing). Loans indexed to the commodities which the borrowers export might also be floated at relatively modest rates, if not the 2½ percent achieved here.

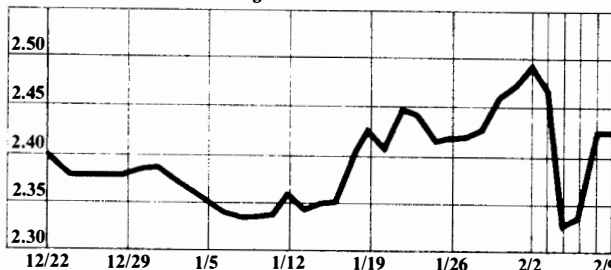
Such proposals are resisted on three grounds, two of which are openly declared. First, the time is not ripe—the classic bureaucratic evasion. Second, it would "let borrowers off the hook," and even prove inflationary—which is pernicious nonsense. There need be no "hook"—the debts, as bankers are the first to protest, would be perfectly reasonable in a reasonable economic environment. And funding itself is not inflationary—on the contrary, it is the principal weapon used by our governments to fight inflation. What is inflationary is to pile more bank debt and more IMF and other resources on past lending. Have the central bankers secretly opted for the the generalised bankruptcy which is called inflation?

The final, unmentioned, problem is this: refinancing sound borrowers in the long-term market will leave the banks with an even more questionable bunch of assets, and somebody might notice. So the banks, too, may need refinancing—a prospect which should depress the share prices found offensive at Ditchley. . . .

## Currency Rates

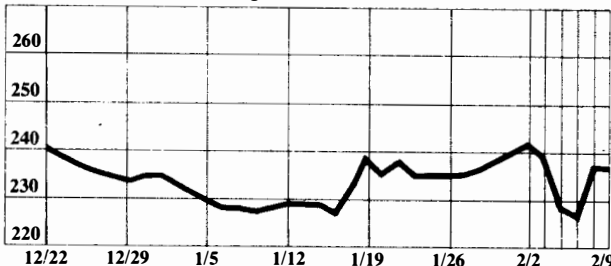
### The dollar in deutschmarks

New York late afternoon fixing



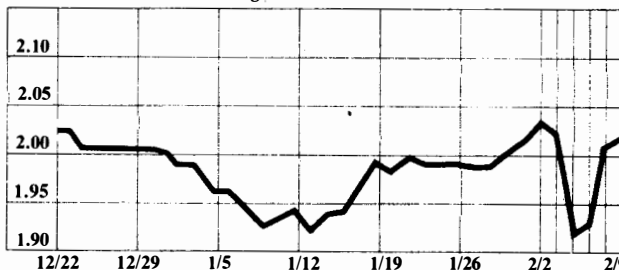
### The dollar in yen

New York late afternoon fixing



### The dollar in Swiss francs

New York late afternoon fixing



### The British pound in dollars

New York late afternoon fixing

