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European Currencies Under Fire

FOREIGN EXCHANGE

Political instability and economic deterioration in Great Britain and France triggered heavy speculative pressures against those countries' currencies early this week. The near collapse of the British Labour Party government produced 6 point and 13 point drops in the London stock market index on Friday, March 18, and Monday, March 21, respectively.

Although the pound sterling managed to rally later in the week based on Bank of England intervention and the Callaghan government's winning of a critical vote of confidence, this week's crisis was an important danger signal. Up until now, the pound's stability has been largely predicated on speculative short-term capital inflows into British stocks and Treasury securities — at the expense of long-term industrial investment. This short-term capital inflow could easily turn into a panicky outflow, as this week's experience attests.

In France, sell orders deluged the Paris bourse in the wake of the Left coalition's victories in the recent municipal elections. The Paris exchange index fell 4.5 percent on March 21 and quotations of six stocks had to be delayed because of lack of buying orders. The French franc was stabilized only at considerable cost to the Bank of France.

In Italy, meanwhile, the Andreotti government averted another lira crisis by accepting the International Monetary Fund's conditions for a $530 million loan — conditions so onerous that their implementation is likely to bring down the government itself and propel Italy into chaos.

U.S. Payments Deficit Deepens

Ironically, the European currency turmoil erupted in the same week that the U.S. Commerce Department released balance of payments figures underscoring the actual weakness of the U.S. dollar. The U.S. current account deficit mounted to $817 million in the fourth quarter of 1976, compared to $729 million in the third quarter, and a $11.7 billion surplus in 1975 as a whole. The deficit was aggravated by a record $20.7 billion surge in U.S. bank foreign loans and transfer of funds to U.S. bank foreign branches — an amount approximately equal to the shortfall in internal funds experienced by U.S. industry from the level required to keep U.S. plant and equipment at replacement levels! Nearly half of this $20.7 billion outflow — $9 billion — occurred in the fourth quarter alone, as U.S. international banks rushed funds abroad to roll-over non-accruing Third World and other loans, an operation euphemistically termed "end-of-year book balancing."

Given this record foreign lending and the $9.2 billion merchandise trade deficit, how did the dollar manage to survive the fourth quarter of 1976? The same Commerce Department figures provide the answer. The central banks of Western Europe, the Middle East oil producers and other U.S. trading partners might have accumulated dollars reluctantly — but lacking any alternative international reserve — simply reinvested their dollars into interest-bearing U.S. Treasury paper, bank certificates of deposit and other U.S. assets at the record rate of $33.1 billion. Official foreign assets in the U.S. soared by $18.1 billion in 1976, half of which represented central bank purchases of U.S. Treasury securities. This inflow neatly balanced the record $43 billion jump in total capital outflow and the $9.2 billion trade deficit, providing the U.S. with a small but steadily worsening deficit on current account.

Such figures point up the extent to which the dollar's

GOLD

Gold Keeps Going Up

Gold prices soared to a new two-year high of $153.25 an ounce in London this week as fears of new European currency turmoil and U.S. dollar inflation continued to mount. Heavy bidding on the Chicago Mercantile Exchange boosted June futures to as high as $155.50. One Chicago source noted that Arab "double orders" in New York and Chicago had bid up prices and accounted for much of the sharp increase in volume traded. In addition, French interests were reported to be feeding the Chicago market with rumors of a gold-backed monetary system.

Pro-gold articles have begun to appear in even such staunch "Eastern banking establishment" organs as the *Baltimore Sun.* According to the gold analyst at the New York-based brokerage firm, Drexel Burnham, "Today, it is the *dis*believers in Gold who constitute the lunatic fringe... gold is undergoing de facto remonetization."

An indication of this is the fact that Western European and Kuwaiti central banks are attempting to sustain East-West trade through large gold-collateralized loans to the Soviet Union. The European Bank for International Settlements (BIS) is reportedly playing an intermediary role — accepting the physical delivery of Soviet gold so that sudden increases in supplies do not disturb the markets, while European central banks arrange the loans. This is regarded as an alternative arrangement to the expanded use of the transfer ruble — albeit a limited one.

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apparent strength is pure political fiction, based on the willingness of Western European governments and others to assist in financing the U.S. national debt — a charade which cannot continue indefinitely.

Yen Hits 34-Month High

The Japanese economy meanwhile, suffered this week from not a falling but a rising currency — as the yen hit a 34-month high of 277.4 yen to the dollar. Rumors are rampant in the market that Prime Minister Fukuda made a deal with the Carter Administration to allow the yen to appreciate — possibly to as high as 270 to the dollar — so as to reduce Japan's huge trade surplus with the U.S. According to the twisted logic of Carter economic advisors, such as C. Fred Bergsten, such a yen revaluation would strengthen the dollar in the long-run.

Common Fund Hoax Dies Quietly

SPECIAL REPORT

Wall Street's Common Fund proposal — to arrange commodity price supports as a mechanism for bailing out their $300 billion of Third World debts — has died. The refusal of the Europeans and Saudi Arabians to contribute to this fund to keep Rockefeller's banks alive led directly to its failure. Final word on its early demise came from the chief of commodities at Chase Manhattan Bank, Mohung Che, who flatly stated in an interview March 21, "I do not think a Common Fund for commodities will be set up, there is even very little chance of reaching a resolution on a commodities-by-commodities basis."

By March 23, the *Journal of Commerce* had published a strong editorial against the scheme, and the following day an aide to Senator Jacob Javits (R-NY) on the Joint Economic Committee indicated he concurred with the Chase assessment. The point was highlighted by failure of the UNCTAD Geneva meetings on copper between consumer and producer nations to even "establish a basis for negotiating an international copper agreement," according to the *Wall Street Journal* March 21.

While the Coordinating Bureau of the Non-Aligned Nations (established at the Colombo Conference of the Non-Aligned in August 1976) still has the Common Fund on its agenda for their April 6-11 meeting in New Delhi, the Yugoslav press reports that the North-South talks scheduled for May might be postponed because of doubts that the major industrial nations will resolve their differences at their early May summit in London. As stated by an analyst at the Wall Street investment banking house Salomon Brothers, "the possibility of any international agreement on commodities is extremely remote; there are so many competing interests they will never be able to agree."

What was clear from the beginning, however, was that the Common Fund proposal, floated by Wall Street's agents within UNCTAD , was never designed to aid the developing countries in their fight to improve their living standards. Not only were the increased revenues to be channelled into debt service, but the rising commodity prices would lead to an increase in world inflation, particularly in the finished goods the developing countries hope to import from the advanced sector. Additionally, the increased commodity costs would result in a secular decline in demand, further exacerbating the LDC earnings crisis.

The only solution for the Third World would have to be one similar to the U.S. Labor Party's *International Development Bank* proposal which calls for a debt mora-

T-Ruble Set To Go

According to a high official of a Comecon member government, every technical and financial arrangement requirement to make the Comecon's transfer ruble the basis for a new monetary system is already in place. Numerous countries outside the Comecon are immediately prepared to join a new monetary system based on the transfer ruble, the source said.

Only political wavering by the Soviet Union stands in the way. The Soviets are afraid that a direct move against the bankrupt dollar would be viewed as an intolerable "provocation" against the United States. Accordingly, last month the Soviets refused to give final approval to a $5-6 billion deal between the USSR and Italy, which would have brought the transfer ruble into major international circulation for the first time.

The Comecon source's judgement was corroborated from the Italian side this week. In a commentary published March 17 by the leading Italian newspaper, *Corriere della Sera*, Italian Communist writer Carlo Boffito explains that setting up three-way trade deals between the Soviets, Europeans, and Third World based on the transfer ruble represents no technical problem. "The operations would require a series of technical agreements and banking guarantees," Boffito says, "that do not present any special difficulty. The reason that there has been so much mystery around the broad utilization of the transfer ruble is obviously political."

The Italian commentator adds, "Given the international level of (dollar) interest rates and the problems in finding international financing, it would be to Italy's advantage to use the transfer ruble." This is also the publicly-stated view of many Italian industrialists, 200 of whom participated in the February delegation to Moscow that tried to negotiate a transfer ruble deal for Italy.