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.