Click here for Full Issue of EIR Volume 4, Number 41, October 11, 1977

Apart from the possibility of London winning "by default" in a crisis situation, or even using market leverage to help the crisis along, one other major strategic element that could work sharply in London's favor is the Mideast situation. The Saudis in particular have avoided concentrating their funds in the United States out of fear of the boycott issue in Congress, preferring London as more hospitable location. Any outbreak of hostilities in the Mideast aversely affecting U.S.-OPEC relations could have a devastating impact on U.S.-based institutions.

*War Against London?*

Western European financial circles are "wise" to the London operation, although perhaps not in every aspect, and the European press has issued a number of direct warnings to the City. *Handelsblatt* of Oct. 4 and *Die Welt* of Oct. 7 ran similar articles accusing the Bank of England of trying to intentionally manipulate the inflow of funds into London securities, warning that West German banks may react by pulling funds out. (West German and other European funds are, along with American funds, the major source of the $13 billion growth of British reserves this year. Arab funds, by one reliable estimate, probably account for no more than $6 billion.) British Savings Bank Federation chief Helmut Geiger toured London last week, warning his British counterparts that if the Bank of England undertook to artificially raise the sterling exchange rate, then West German banks would no longer invest their surplus funds in London.

Privately, some European financial circles are speaking of "financial war against London," particularly in France and Belgium. One of the big U.S. commercial banks predicts that when the speculative bubble on the London market bursts, sterling will get into deep trouble. In their estimate, $10 billion of the total $13 billion reserve increase this year represents hot money, and could flow out again just as easily. Exactly how badly London would be hit by a collapse of the bubble is hard to determine. At the moment funds are still coming in, although more cautiously, particularly into longer-dated gilt-edged bonds, taking advantage of the 400 basis point spread between short and long-term rates. Even the London banking houses expect the market to shakeout hastily in the near future. This is not of immediate concern to Lazard, Rothschilds, or Warburgs, since most of their operations are in dollars. But their financial opponents could use the opportunity to press home the attack.

# British Manipulate Dollar Collapse, Move For Pax Britannica

Large-scale dumping of dollars in London, Tokyo, and European continental money markets sent the U.S. currency reeling last week in the wake of the International Monetary Fund's policy debacle. City of London bankers publicly gloated over the dollar's embarrassment, as the British pound soared above the $1.76 mark for the first time this year. The Japanese currency recorded an all-time high of 259 yen to the dollar.

## FOREIGN EXCHANGE

Although British Chancellor of the Exchequer Denis Healey failed in his efforts at the IMF annual meeting to impose a worldwide reflation to prop London's own speculative investments, British financiers have instead activated their "fall-back" option — maneuvers to "come out on top" in the context of a complete collapse of international markets and a new world depression.

Cheering on the dollar collapse, the Oct. 5 *London Times* boasted that a "a declining trend is inevitable because of the American trade gap...The dollar is still bolstered by the inflow of funds from oil-exporting countries, but more of these are being recycled into pounds, German marks and other strong currencies as the dollar drops."

Speaking in purely technical terms, the London banks also stand to lose by the dollar's fall. Due to the longstanding bankruptcy of the pound sterling, British banks are forced to conduct most of their international lending in U.S. dollars. Nevertheless, London hopes that its strategic control over Arab petromoney deposits and the political clout of its intelligence apparatus will allow British finance to eventually preside over the ruins of the world's industry.

Ironically, major U.S. commercial banks have fallen in line with the British game. At least one large New York commercial bank and a San Francisco-based institution have been cynically speculating on a dollar decline. Morgan Guaranty's widely read newsletter *World Financial Markets*, authored by senior economist Rimmer de Vries, helped to spur on the dollar collapse this week. De Vries put out the self-defeating line that dollar instability was unavoidable and recommended as "solutions" the "selective" revaluation of the Japanese yen, energy czar James Schlesinger's proposed reductions in U.S. energy consumption (thereby destroying U.S. industry), and a U.S. export drive (protectionism).

Reflecting the massive buildup of "short" positions in the dollar by international banks and corporations, the six-month Eurodollar rate shot up to 7.5 percent on Oct. 6 compared to only 6.125 percent for the pound sterling.

*No Monetary Solutions for Dollar*

As *Business Week* columnist William Wolman, the *New York Times'* Leonard Silk, and other commentators recently pointed out, the U.S. Federal Reserve has been



© 1977 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

placed in a "no win" situation where no amount of simple jiggling with interest rates or money supply can save the dollar. The apparent paradox is that short-term interest rates have soared while the U.S. money supply grows at double-digit annual rates, creating simultaneously an excess and shortage of liquidity!

The paradox is explained by John Maynard Keynes' so-called "liquidity preference" formula: in periods of extreme crisis of confidence, investors prefer to hold their funds in cash or shorter-term instruments rather than in illiquid assets. This has tended to accelerate money supply growth, causing the Federal Reserve to raise short-term interest rates in a futile effort to cool the inflationary expansion. At the same time, long-term rates have actually tended to decline or flatten as industrial corporations became increasingly reluctant to invest in new plant and equipment. This "flattening of the yield curve" — as short-term and long-term rates move closer together — tends to accelerate the flight of capital out of long-term bonds into short-term instruments.

Thus, Fed chief Arthur Burns' dilemma: if he continues to allow the money supply to expand, he will provoke an inflationary explosion; if he hikes up short-term rates even more, long-term rates will shoot up as well, destroying the U.S. industrial recovery. According to a spokesman for British brokerage house Arnhold S. Bleichroeder, the further jacking up of short-term rates in the U.S. would so destabilize the long-term U.S. securities market that OPEC investors would be forced to flee from the dollar into the pound sterling — even despite the fragility of the British gilt "bubble"!

The British and New York-based Lazard Frères could then emerge hegemonic in a global Keynesian paradise of government-sponsored "public employment" boondoggles financed through massive issues of short-term "Mefo bills"... while productive industry is cartelized and rationalized out of existence.

Incredibly enough, conservative commercial bankers in the U.S., relying on mechanistic economics of "Brazilian miracle worker" Milton Friedman, believe that the dollar can still be stabilized by simply raising short-term rates. One Mellon family-linked banker told West German businessmen in Frankfurt last week that the U.S. banks' prime rate will be hiked to 8.5 percent and this will "save the dollar." What better recipe for knocking the props out of U.S. industry! Similarly, St. Louis Federal Reserve Vice-President Denis Karnowsky, in a recent interview, clung to the hope that investors will not desert long-term instruments as short-term rates rise.

*Canadian Dollar — Another Casualty*

Meanwhile, the Canadian dollar, which is closely tied to the U.S. currency for obvious reasons, has been swept along in the U.S. dollar's collapse. The Canadian dollar fell to a new eight-year low of $.9195 on Oct. 6, after the Canadian Financer Minister "pulled a Blumenthal", in the words of a Citibank foreign exchange trader. The Canadian central bank, whose foreign currency reserves are at an all-time low, will not intervene in support of the currency, while Finance Minister Jean Chretien announced he did not mind the decline in the exchange rate since this would give a boost to exports!

Also on Oct. 6, the Bank of England decided to intervene only minimally in support of the dollar, in an attempt to cool — without breaking altogether — the inflationary inflow of foreign capital into the London gilts market. Previously, the Bank of England had been buying up huge amounts of dollars for its reserves, forcing it to print up pounds and creating an inflationary surge in British money supply. As a result, British foreign currency reserves hit a record $17.2 billion in September. By allowing the pound to float upwards against the dollar to the $1.76 level, the BOE hopes to avoid — at least temporarily — printing up more pounds.

A British-influenced West German journalist summed up the British currency strategy this way: "The pound can't move higher. It'll be stable but no stronger. With the oil money flowing, with the shocks the dollar is going to receive, the pound will be stable."

Some West German investors, however are threatening to call London's bluff by pointing out that there is no real substance beneath the gilt market fluff. Helmut Geiger, the head of the West German savings bank association, visited London last week and warned publicly that the British inflation rate is still too high. Although German banks have been placing their surplus liquidity into gilts up till now, Geiger said, they may decide to discontinue this practice in the future.

*— Alice Roth*

# British, U.S. Banks Scramble For OPEC Funds

After plans to restructure the world banking system at the Washington International Monetary Fund meeting went under at the end of September, the first week of October witnessed international financial brawl for control over what all observers see as impending monetary holocaust.

The City of London has announced in every financial outlet at its disposal the most significant result of the IMF fiasco: the $1 trillion-plus structure of international dollar debt, starting with Peru, Turkey, and a host of other Third World countries, is headed for default. As the excerpts below from leading journals indicate, the British have decided that the U.S. commercial banks will be bankrupted, and that rather than mourning their failed IMF attempts at a dollar-sterling axis, London should make hay while the dollar slides.

"No safety net could save the dollar," said the top British bank Schröder's in London yesterday. "What's happening to it is what happened to sterling long ago. There's any number of ways to destroy the dollar. If the Arabs stop dollar purchases, here we are...You know what I'd really like to see? I'd like to see the big U.S. banks collapse. That would be great. They're far too powerful."