February Trade Figures Clobber Dollar

The dollar fell back sharply to 2.005 deutschemarks, 1.83 Swiss francs, and 2.2150 yen following the March 31 announcement of a record $4.52 billion trade deficit during February, double the January level of $2.38 billion. The announcement took the market entirely by surprise — the dollar had been rising on all markets up until the moment of the announcement — and foreign exchange traders, who have not yet fully digested the news, expect the dollar to dip again below the 2.00 deutschemark line.

FOREIGN EXCHANGE

Unless the current export-promotion efforts of Ambassador Strauss, Assistant Secretary Weil, and other Administration officials take hold quickly, the prospect for the dollar will be grim. Preliminary cross-checking indicates that the February deficit is not an aberration, but reflects a basic deterioration of the U.S. manufactures trade balance.

Imports rose 14.4 percent and exports fell 1 percent, with all the changes occurring in the key industrial categories. Imports of manufactured goods, of which the largest component was steel, rose by $400 million. Import increases occurred in machinery, transportation equipment, motor vehicles, steel, and aircraft. The more volatile fuels and agricultural products categories were stable over the month.

Historically, the manufacturing balance has been the largest surplus item in the American trade balance, but fell from $20.7 billion in 1975 to $12.7 billion in 1976 and $3.7 billion in 1977. Conceivably, the United States could go into deficit on manufactures during 1978, for the first time since the war.

There has not been sufficient time before deadline to examine all the major categories of the balance of payments. However, the steel sector is exemplary of the problem. Net imported steel rose from 1.537 million tons in January to 2.219 million tons in February. The explanation currently circulating is that importers sought to beat the Feb. 21 deadline for imposition of the Treasury's reference prices on steel imports. However, steel analysts do not believe that import volume will decrease substantially with respect to last year, despite the reference prices. Blyth, Eastman, Dillon projects an import level for 1978 of 16 to 17 million tons, as opposed to 18 million tons last year. The reason is that the discrepancy between imported and domestic steel prices will apparently remain in place. The most recent round of steel price increases, namely U.S. Steel's rise of $10.50 per ton and National Steel's rise of $5.50 per ton, will enable foreign steel suppliers to continue to export to the U.S. despite their sharp export price increases due to dollar depreciation. In turn, domestic steel suppliers—using the Treasury's reference prices as a floor — will also increase their prices.

Whether this neatly interlocking arrangement has anything to do with the surprising calm with which foreign steel suppliers met the reference price system in the first place is open to question. What is clear is that the manufactures trade balance incorporates a process of capacity shutdown, lower volume, and higher prices. Since the devaluation of the dollar over the last six months has increased import prices and lowered export earnings in foreign-currency terms, the basic industrial position of the United States has become the primary victim of the process. Without a basic reversal of American trade policy, the trade deficit can be expected to deteriorate throughout 1978 on the manufactures account. Even if Alaskan oil and lower oil consumption cut back the fuels deficit, the gross size of the deficit will reflect even greater disadvantage to the American economy than the corresponding figures for 1977.

Most economists believe that the $4.5 billion February figure is far above the underlying level of deficit; all the special factors have not yet been sorted out. However, the February deficit is an unmistakable warning about the longer term health of the American economy.

French Franc to Return to the European Snake?

State Department officials speculate that the French franc might return to the European snake in advance of the July summit in Bonn, establishing a Franco-German alliance against the "convoy" reflation approach pushed by Britain's Prime Minister Callaghan. State Department official Henry Owen and his associates reportedly see this as a major threat to their plans for the summit, which reduce to forcing the West Germans and Japanese to swallow the Callaghan program. There are even indications that Secretary of State Cyrus Vance and officials close to him are trying to end-run the Owen operation, and supporting a Franco-German initiative.

Société Génerale de Belgique Chairman Albert Coppe told a New York Banking audience March 29 that a return of the French franc to the snake was likely.

Sterling in Trouble

The pound sterling dropped from its recent $1.88-1.89 level to a 1978 low of $1.86 on March 30. Market-watchers agree, first, that the Bank of England wants to ease the pound's parities to cheapen exports — sterling dropped against other currencies beside the dollar; and second, that the awesome dilapidation of the United Kingdom's economy, no longer glazed over by North Sea oil, not only precipitated sterling's slide but may speed it past Threadneedle Street's brakes. This would knock out key

City of London capacities, including Prime Minister Callaghan's courage to lecture the United States on the impressive fruits of United Kingdom domestic austerity, capital controls, and incomes policies.

Credit policy is also a sound way to understand the deterioration of the pound sterling, as it catches up with the deterioration of the productive economy. As the American Banking Association testified at the final stage of UK hearings on City of London operations chaired by the Labour Party's Harold Wilson, the British method has been "liquidation" of the productive assets of any firm that couldn't keep up with its debt schedule, whereas American commercial banks work actively with their corporate customers to make the borrower a better "going concern," at best on the basis of actual innovation and expansion.

The industrial post mortem on the British economy has been delayed for many months by London's ability to draw international investors into sterling paper — especially government "gilts" — by vaunting the $20 billion national reserves amassed since 1976. The material prop to these pretensions — floods of North Sea oil revenue — has now become discredited; British exports are lagging; and, according to the fine print in the Bank of England quarterly report, the $20 billion reserves, if netted out, would be a £7.3 billion deficit as of September 1977, even before the trade drop intensified. The gross figure not only fails to account for long-term post-World War II U.S. loans which London never intended to repay, and whose payment has never been demanded; it includes public-sector medium-term borrowings and special foreign-currency bonds that will have to be met.

The *International Currency Review* of London, an intelligence sheet with increasingly canceled subscriptions from New York bankers because of its anti-dollar purple prose, stated this month that "before the end of the year there is likely to be a catastrophic collapse of confidence in sterling — the development of which is currently being deferred only by the U.S. dollar's persistent international weakness." Whatever the ICR's motives in raising such an alarum about sterling (motives possibly including the hope of restoring credibility among their disgusted New York commercial bank subscribers) the inverse pound-dollar relationship is now being taken for granted. For example, the March 31 *Journal of Commerce* cites a New York banker predicting that "if the dollar strengthens by any appreciable amount, the pound would be likely to go lower" than the $1.80 level he foresees soon.

West German bankers figure the pound considerably lower, and along with the Italian press have been maliciously reminding the UK about its $20 billion foreign debt. Much of this debt comes due in 1980-82, and London's well-advertised payments of small portions ahead of time to the International Monetary Fund and Chase Manhattan are openly viewed in New York as efforts to get a jump on the crisis of confidence.

In July 1977, the Bank of England officially severed its "buffer" reserve relationship to the dollar. Since then, London has daily campaigned for the demotion of the dollar and its role in world trade and investment. It is a crass and therefore fitting irony that one of the things eroding the pound sterling in the last week of March was the expectation of a reflationary budget of the kind Callaghan has been urging on all the advanced-sector OECD countries except the U.S. which is supposed to "contract." The "danger that the Bank of England couldn't control the situation if it started to allow the pound to slide" as the March 31 *Journal of Commerce* put it, has so much international leverage at stake that the Bank of England should be expected to step in soon to try to prop up the UK's pretensions as world arbitrator.

Congress Could Collapse World Bank

According to a high official in the World Bank, that institution will collapse unless the Carter Administration mounts a "Panama Canal Treaty" mobilization to get its heavy new funding requirements through Congress. The official stated that the House of Representatives was a particular obstacle, with an unusual assortment of different congressional interest groups opposed to the new funding requests, each for their own reason. The official indicated he was not certain that the Carter Administration would rise to the occasion.

The *New York Times*, a strong supporter of the World Bank's labor-intensive austerity programs, rushed correspondent Graham Hovey to press March 28, with an article mistitled "White House Defends World Bank Against Hostility of Congressmen" — a bald lie. As the article itself indicated, it was Vice-President Walter Mondale and Sen. Jacob Javits who were principally concerned about the threatened demise of the World Bank, not President Carter. This was not contradicted by the interviews with the World Bank official, excerpts of which follow:

Q: We saw the New York Times *article this morning. Are things really that bad for the World Bank?*
A: Yes, Hovey's article is accurate.

Q: It seems like you people are getting hit from all sides, aren't you?
A: You aren't kidding! The worst is the House. There's the conservatives who hate the World Bank. There's the human rights people with their impossible riders. There's the antihuman rights people who want Nicarigua but not Vietnam. There's the palm oil lobby that doesn't want U.S. money to go to countries competing with us in palm oil. There's the sugar lobby, there's the soybean lobby, that was last year.

If that wasn't enough, this year there's going to be a steel lobby, a shoe lobby, and a textile lobby. Then there's (Under Secretary of State) Warren Christopher