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Blumenthal-Miller Dollar Wreckage Plans Are On Track

The dollar weakened by over 1 percent against other major currencies during the week of May 23 to May 31. The prevalent explanation — a batch of adverse economic figures testifying once more that "the fundamentals" of the U.S. economy have not improved — is not strictly false, but misleading.

FOREIGN EXCHANGE

At this point, market developments can only be understood with reference to the May 24-25 statements by the Treasury Secretary and his factional allies in the State Department's monetary affairs division (reported fully in *Executive Intelligence Review*, Vol. V, No. 21), statements that Blumenthal is ready to "talk down the dollar" into "another blow-out" to unseat President Carter and force the July economic summit meeting of Western heads of state to ratify International Monetary Fund police powers against advanced-sector government. The hoary issue of West German and Japanese "reflation" is being used by both witting and unwitting spokesmen to provide an *ante hoc* rationale for the deliberate dollar collapse.

Crisis Management

The psychological climate for Blumenthal's inside wrecking job has been reinforced by a spate of U.S. commercial bank forecasts and Western European statements on dollar weakness, recessionary omens, and energy-contraction policies which, by a logic as perverse as it is widespread, are supposed to bolster the dollar and business confidence.

Morgan Guaranty's latest monthly issue of *World Financial Markets* argues that the dollar's recovery in past weeks has been based principally on a reversal of the "leads and lags" (i.e., export-importers have stopped stalling on their dollar purchases and rushing their dollar payouts in the expectation of dollar depreciation). Moves into dollar equities, Morgan says, account for only a small dimension of the currency's upswing, an upswing which thus remains extremely fragile without "reversal of the growth gap between the United States and foreign economies" (West German and Japanese reflation), "an effective policy to curtail the secular growth of oil imports" with a sop toward "encouragement of technological dynamism" and "greater exports."

Manufacturers Hanover writes that the only alternative to further devastating Federal Reserve credit-tightening is oil-import cuts; Alan Lerner of Bankers Trust observes that the present credit crunch is already driving consumers and some industrial borrowers out of the markets — concluding that recession will eventually draw rates down again, an argument that can also be applied to rationalize the unwinding of "the Miller miracle."

The formulation — originally floated earlier in May by Henry Wallich of the Federal Reserve — continued to dominate European statements, as when Alexandre Lamfalussy of the Bank for International Settlements' economics staff told a European-Arab Dialogue gathering that dollar turbulence will continue until (a) the U.S. reduces oil imports and (b) West Germany reflates.

Such statements, apart from their less than inspiring effect on the markets, are inducing currency specialists, for example at the Frankfurt-based Commerzbank, to term a dollar fall "inevitable." The West German central bank, meanwhile, performed quite heavy dollar-support interventions at the end of May and beginning of June, according to continental traders. But the evidence of such action only fed the markets' pessimism and the dollar continued to fall to the 2.08 level. On the Eurobond markets, the deutschemark sector has begun to boom again while the dollar sector languishes, since the prospect of future continuation of dollar interest-rate rises discourages borrowers and invites lenders to hold off.

The West German Angle

While Blumenthal, the British-dominated Organization for Economic Cooperation and Development, and assorted characters like Lamfalussy continue to press for West Germany to "stimulate its economy," Bonn — most recently in a May 31 press conference by Finance Minister Hans Matthoefer — continues to still more adamantly refuse. This is on its own terms sensible of the Germans, but their mere stubborn defensiveness is being plugged into the Blumenthal-Miller "bear" plan: Bonn's refusal ("Bonn Resistance To Reflationary Steps Seen Rising" was the international lead in the June 1, *Journal of Commerce)* is being used as psychological warfare to further unsettle the markets, plump for U.S. austerity, and pave the way for the dollar collapse scheduled by Blumenthal and Miller themselves. To the extent that the Chancellory is manipulated into offering concessions in exchange for their "no" to reflation, e.g., the concession of public openness toward London's schemes for European monetary integration at the ultimate expense of the dollar, the Treasury and Fed operatives are all the more able to skew the political negotiating climate away from U.S. participation in the energy development, world trade and investment expansion proposals that West Germany and France, along with the USSR, are counting on for their own survival.

One of the broader and subtler disorientation statements came on May 31 from Rainer Gut, the chief executive of the Crédit Suisse bank. Gut, a Lazard Fréres man who was put into Crédit Suisse in the wake of a "Chiasso scandal" arranged partly to that end, told a

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group of European and American businessmen at a Conference Board meeting in Geneva that "a somewhat more stringent payments balance discipline" was required in the U.S. to stem "a tidal wave of dollars" in the rest of the world. Gut repeated the claim that the U.S. is "malignly neglecting" the dollar in order to underprice dollar exports — a falsehood both obscuring Blumenthal's motives and promoting the emergence of trade-war wrangles at the July summit.

Most significantly, Gut said that "The major monetary problem of our time . . . is the task of inducing the OPEC surplus countries to assume a greater share of world economic responsibility" — an effort to pressure Saudi Arabia into giving sanction and funding for the International Monetary Fund directorate of the world economy Blumenthal and the State Department monetary affairs division outlined in May.

Meanwhile, Reuters claimed that the traders at the June 1 session of the international foreign exchange conference in Munich were universally "pessimistic" about the dollar's near-term prospects, even if an energy-bill compromise clears Congress, and the dollar's weakness would mean a dangerous growth in West German and other money supplies via market intervention to buy dollars in support. The central bank chiefs of Japan and West Germany, Morinaga and Emminger, made public noises about their past and future efforts to reach "growth" targets that allegedly aid the dollar. The markets on both sides of the Atlantic were dead — because the senior traders, before leaving for Munich, had instructed their subordinates not to do anything in their absence.

— Susan Johnson

Manny Hanny Says: Cut Energy Imports

The following is excerpted from the Manufacturers Hanover Trust Financial Digest *of May 29:*

International considerations may also help to explain the Fed's recent aggressiveness. Despite massive foreign central bank support throughout 1977 and early 1978, there was a free-falling U.S. dollar in the foreign exchange markets during this period. Foreign psychology, however, did turn favorable almost simultaneously with the start of the Fed's tightening move in mid-April. Moreover, there is an economic summit meeting in Bonn coming up in mid-July. In the past, similar high-level jamborees succeeded only in releasing hot air that proved insufficient to realize stated objectives. But this one might prove different.

Europeans consider the slide in the dollar as a primary deterrent to a faster economic rebound there, and, in the face of a strengthening of the forces that argue for reflation, they might not tolerate another slide in the U.S. currency this year. Consequently it is conceivable that the Fed might be compelled to force domestic interest rates still higher in the period ahead in order to demonstrate that the U.S. intends to do its share in defending the dollar. But whether this attitude implies credit "crunch" conditions is an open question. Meanwhile, any positive steps toward fashioning an energy policy would not only convince foreigners that the U. S. is serious about correcting its trade deficit, but would also provide the Fed with greater flexibility in the development of monetary policy targets.

Morgan Guaranty Agrees

This is a portion of an article from the May issue of Morgan Guaranty Trust Company's World Financial Markets:

Given the major real effective depreciation of the dollar in the early seventies it may be surprising that the U.S. payments deficit is once again so adverse. Some observers conclude from the U.S. experience and others that the power of real effective exchange rate change to remedy imbalances is quite limited. The clearer lesson of the present U.S. deficit is the dominant influence on payments trends of cyclical factors and fundamental structural change. Growth of the U.S. economy has markedly outpaced performance of other industrial countries since 1973-74. U.S. dependence on petroleum imports mushroomed from negligible levels in the sixties to nearly 45 percent of domestic consumption last year. Also at work, and cumulatively significant, are trends in new technology and the spread of sophisticated manufacturing know-how in Asia and elsewhere, leading to increasing import penetration of the singularly attractive U.S. market.

Overcoming these forces requires reversal of the growth gap between the United States and foreign economies, an effective policy to curtail the secular growth of oil imports, the encouragement of U.S. technological dynamism, greater emphasis on exports, and progress in lowering trade barriers the world over. In their absence, the needed adjustment toward a viable structure of current account balances probably will require real effective exchange rate adjustments on a scale distinctly greater than the minor magnitudes of recent years. This conclusion may be unwelcome, if inescapable. Those who see the legitimate function of exchange rate change to be no more than the offsetting of inflation differentials introduce a rigidity in the managed floating system that rivals the rigidities under the old fixed-rate system.