GOLD

Bear trap!

At deadline Aug. 9, the bullion price had recovered to $300 an ounce after plunging from a record high of $307 to $282 within only two weeks. Gold's rebound was fueled by reports that the OPEC finance ministers will reconsider the role of the U.S. dollar in oil pricing at their scheduled meeting next month. According to the Aug. 9 *Journal of Commerce*, "rumors have been circulating that the OPEC countries might even link the price of oil to gold."

Indeed, as I reported two weeks ago, continental European and Arab leaders are negotiating the establishment of a new official gold price as part of an emerging Euro-Arab zone of economic and military cooperation. Dresdner Bank managing director Hans-Joachim Schreiber hinted at the move towards a new gold standard in a *Wirtschaftswoche* article written two weeks ago, predicting that the gold price will rise to a 15-fold mulitple of the oil price, or $330 to $350 an ounce.

The gold price setback was engineered by City of London financial interests in a rearguard attempt to sabotage the emerging Euro-Arab consensus around remonetizing gold. The British attempted to panic the gold market by circulating two categories of rumors: (1) That U.S. recession would drag down the gold price 1975-style, by dampening industrial demand for the metal and reducing the attractiveness of gold investment as a hedge against inflation. (This was the line of argument taken by Christopher Glynn, a top official at the London-based mining finance house Consolidated Goldfields.) And (2) that the U.S. Treasury, and possibly the International Monetary Fund as well, would increase the volume of their gold sales in this recessionary environment, again threatening a repeat of the 1975 gold market fiasco. To provide some semblance of psychological truth to the rumors, the London interests initiated heavy selling of silver, whose price movements have at times, but by no means always, been closely associated with those of gold.

However, a repeat of 1975 was never a real possibility, because Euroepan governments, who earlier this year pooled their gold reserves in the European Monetary System, have placed a floor under the gold

INTERNATIONAL CREDIT

Locomotive demands on B.R.D. to throw credit off EMS track

West German banks are using long-term foreign IOU's to help finance what is emerging as an unofficial Phase Two of the European Monetary System. Phase One stabilized internal currency parities and established a floor under the dollar; Phase Two—the core of the plan—is a redirection of world credit flows into industrialization and high-technology energy development. The much-touted "aggressive" Euromarket lending by West German banks, combined with their moves toward remonetizing gold in conjunction with France, has been the answer to U.S. and International Monetary Fund demands at the Tokyo summit of Western leaders last month that Europe "deflate"—i.e. halt its volume and low-interest terms on loans to the Third World and less-developed OECD borrowers. And it is this aggressive lending that is the target of the otherwise mysterious demands this month by the IMF and Anglo-American financial press that West Germany adopt the IMF's 1978 "locomotive strategy" and "reflate"—i.e., keep its credit to itself.

One resource fueling this year's expanded lending to West German banks, and West Germany's export growth in turn, has been a spurt of foreign borrowing by those banks. The Bundesbank, the Frankfurt-based central bank, records in its July report that institutions' total liabilities of longer than one year have leaped from 38.6 billion deutschemarks as of last December to 45.6 billion at the end of May. Since the beginning of 1978, the increase has been 22 billion marks—almost the total volume of longer-term capital raised abroad in the previous three decades combined. This reflects two important principles: attracting foreign funds for productive recycling, and specifically using OPEC deposits for increased Third World lending.

Much of the borrowing over the past 17 months by West German banks, according to the Aug. 6 London *Financial Times*, has taken the form of *Schuldscheine*, or promissory notes. This instrument, traditionally used by government entities, is relatively attractive to lenders abroad because it is exempt from the 25 percent coupon tax imposed on foreign buyers of domestic bonds. For the banking borrower it has the advanprice. According to Thomas Wolfe, a well-known Washington consultant who advised the Ford Administration's Treasury Department, European, Arab and other governments have in recent months been buying at least 20 percent of new gold supplies as they come into the market, dwarfing private speculators. British bullion interests, who control only about 3 million ounces of speculative (non-industrial) gold demand out of a total world market of approximately 50 million ounces, have been overshadowed by the Dresdner Bank and other large West German, French, and Swiss banks who buy for these governments.

Since the beginning of this year, Wolfe reports, the Bundesbank has enlarged its gold holdings by 10 percent. The increase does not show up in the official IMF statistics, because these new reserves are held up by the Dresdner Bank in a special Bundesbank account. Under a three-year international agreement which expired March 1978, the Group of Ten central banks were prevented from adding to their gold holdings. Although it is now "legal" for them to buy gold, the Bundesbank and other European central banks are, in so doing, openly flouting the U.S. Treasury and IMF, whose policy is completely to eliminate gold's role from the monetary system. Moreover, the U.S. Treasury does not dare increase its gold sales now because to do so would only further feed Europe's holdings.

Given European governments' commitment to gold, any weakness in the gold price should be stricly limited and of short duration. Although gold may continue to fluctuate widely in the coming months as the battle between British and continental European gold market forces deepens, it seems unlikely that the price will slip below $275; the upper price limit is probably around $350, Schreiber's target.

Recent Soviet gold market activity would appear to substantiate this projected price range. The South African *Financial Mail* reported in mid-July that the Soviets, who are among the world's shrewdest gold traders, had reappeared in the market after a long absence but were selling only above $280. Furthermore, the Soviets, acting as if they were coordinating with the Europeans, were careful to increase their sales by exactly the amount of the U.S. reduction and no more.

No doubt, Britain's latest attempted "bear raid" succeeded merely in shaking some gold out of the hands of gullible small-time speculators and into firmer, continental European and Arab hands.

—***Alice Roth***

---

tage, if the *Schuldschein* term exceeds four years, of exemption from minimum reserve requirements maintained for shorter-term foreign liabilities.

Those borrowers, according to the *Financial Times*, have prominently included the *Landesbanken*, the large regional banks owned by the federal states.

The *Financial Times* reports that large amounts of *Schuldscheine* have been bought by OPEC central banks, a development that paper's correspondent plays as a move to diversify reserves away from the dollar. Put more positively, the financing reflects favorable economic relations. And Third World central banks, also said to be purchasing *Schuldscheine*, are probably to some extent doing so as a form of compensatory balance—deposits representing a portion of a loan from that bank to the depositor.

Meanwhile, the Bundesbank has declined to impose reserve requirements on the banks' *Schuldschein* borrowing, despite persistent rumors that it would move to cut off this source of funds, and the *Financial Times* sees no prospect that it will do so in the future. Further, *Business Week* recently called attention to the Bundesbank's "quiet" decision last month to raise the money supply growth target from 6 to 9 percent, and not to introduce limits on banks' discount-facility borrowing. Nor are further interest-rate hikes expected.

Domestic borrowing demand is up 75 percent this year; as we reported last week, the sturdiness of export orders is enabling, or compelling, the kind of capacity expansion that has boosted the economy as a whole. Reflecting healthy import demand as well as increased oil prices, West Germany is now in current account deficit.

Thus financial analysts were startled by a report Aug. 3 in the *New York Times* that the International Monetary Fund is "investigating" West German authorities for their excessively tight interest rates—a report accompanied by a lead editorial, "Defending the Dollar Too Much," which warns West Germany to hold down interest rates and cut its payments surplus to help prevent "an overvalued dollar," and a worsened U.S. trade deficit.

This switch from the "deflationary" "unlocomotive" formulas preceding Tokyo to the 1978 slogan that Europe and Japan must loosen up and become "locomotives" of import demand has nothing to do with payments equilibrium or domestic stimulation per se. It is a defensive, contorted demand that West Germany and France follow Japan's new example: take their liquidity and stick it anywhere but in the international markets, where it is undercutting the IMF's ability to impose "conditional," murderous financing terms as lender of last resort.

—***Susan Johnson***