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INTERNATIONAL CREDIT

Euromarket shakeout in the works

London's bid this week to become the leading international banking center once more is based on a bet that the United States will pull back into a North American economic zone—taking enough Eurodollar liquidity with it to dry up continental Europe's international lending as well.

Expectations are mounting of U.S. capital controls: things have reached a point at which West German thinktankers say Frankfurt has contingency plans to abolish all restrictions on inflows, so it can capture the flight money outside the U.S. Federal Reserve jurisdiction. To this Lazard Freres of New York replies, "If the Europeans try anything, we can expatriate all the working capital from Western Europe. That's $150 billion—boom! Half the floating base of the Euromarket—see how they like it."

Asked what would happen if Europe responded by simply activating its gold reserves at a $350-per-ounce valuation and issuing new credits against this $147 billion backing, Lazards said, "Then you have two markets, one backed by gold and the other by American grain."

If Volcker goes for capital controls, West Germany could indeed pull in overseas dollars in the short run. But European credit and trade would be painfully vulnerable in the unravelling world economy U.S. "autarky" would precipitate. Frankfurt bankers claim they can limp through a world recession the way they survived 1974-75—by belt-tightening. But no full-scale capital markets crisis materialized in 1974-75. This prospect is now undoubtedly intensifying intra-European battles over when and how to activate the international development fund plans mooted when the European Monetary System emerged 15 months ago, plans currently pressed by the Iraqi and Mexican governments, by Saudi factions, and by the leadership of the Nonaligned Movement.

While the EMS hangs fire on activating its massive gold and dollar reserves to meet the threatened credit gap, London and costrategists in Switzerland are moving to provoke a dollar blowout and reorganize world

FOREIGN EXCHANGE

Hit against dollar to prime sterling's role

The British Exchequer announced Oct. 23 that all restrictions on U.K. citizen's purchases and use of foreign currency have been lifted. The announcement came as something of a surprise, though the move had been mooted since the advent of the Tory government in May. The investment premium surcharge on dollars used to buy into foreign securities had gradually declined this year to the 5-6 percent range, but had not narrowed further this week in anticipation of an end to restrictions.

"No one expects a mad outflow of capital," as Barclays put it, noting that major investors like the British Coal Board or Midland Bank have had no difficulty in buying up American equity while controls were still in effect.

The intent is not simply acceleration of the "buy America cheap" gambit first set forth in the London *Economist* two years ago. The City anticipates a dollar tailspin as fixed-income dollar assets are unloaded. The U.S. currency has been fairly strong only because of a temporary demand for dollars due to higher oil prices. With or without ensuing full scale capital and exchange controls on the U.S. side, London is now poised to make "petrosterling' a reserve currency once more. New York's Citibank foreign exchange advisors foresee "outflows from Britain in the short term, more inflows in the longer term."

The Oct. 24 Lex column of the London *Financial Times* asserts that London will "start to claw its way back into lost markets" (there has just been an agreement between the London Metals Exchange and Stock Exchange to establish a gold futures market). "The challenge of a new era" will involve 1) sterling finance of third-country trade (prohibited since 1976), 2) building up, with reservations, overseas sterling balances, and 3) mammoth investment in North America and the Pacific Basin at the expense of "a demoralized Wall Street." The editorial in the same issue exults, "Britain will resume its role as a capital exporter." London *Telegraph* commentator Hamish McRae rejoins, "Don't be too euphoric, watch out, because this is a gamble."

—*Susan Johnson*

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lending at the expense of "useless eaters." A crisis in the Eurodollar bond markets, spreading to all fixed-income dollar assets in Volcker's zooming interest-rate atmosphere, can trigger the blowout. Short-term Eurodollar interest rates continued to climb this week; Eurodollar bond prices lost 1.-1.5 percent in one day; and the London *Financial Times* announced a "near panic" with "nasty institutional losses" on Eurobonds at the same time they note that many Third World borrowers cannot service their debts at current rates.

Under the Bundesbank's tight-money regime, both West German call money and short-term Euro-deutschemark rates continue to rise as well. The domestic bond market is a mess: on Oct. 23 the federal capital markets committee reduced the issues authorized for the coming four weeks to 470 million marks' worth, down from 700 million the month before. No corporate issues were included. The German Bankers' Association warns that the 4 million DM bond for the U.S. Treasury announced Oct. 24 will "crowd" the situation further.

Luxembourg subsidiaries of West German banks are now dumping their bond portfolios on the market because they cannot afford to carry them at the present high interest rates. Market sources expect up to half a billion marks' worth of this kind of liquidation in the last week of October. All four of the total 400 million marks in new Euromark bond issues have been stillborn.

In Italy, a 13 percent cut in their ceiling on credit to industry has just been announced, as the prime rate reached 16 percent, and price increases of 15-21 percent have been imposed on medicine, transport, electricity and heating.

LDC crackdown

According to unconfirmed reports, the International Monetary Fund will provide no further credit to Turkey "until it has a stable government," and British banks will observe the ban. Zaire faces tough debt renegotiations. The Bank of England is rumored to be organizing a supervisory commission to ration credit to Latin America.

The danger of a deliberate destabilization of Brazilian debt is uppermost in many minds, but there is a further angle. Geoffrey Bell of Schröders Bank, chief advisor to Venezuela on management of its petrodollar reserves, is reported to be escalating his ongoing pressure on Venezuelan authorities to diversify the reserves out of the dollar and into sterling—with the help of provocations from the U.S. State Department (see Latin America). The roof could be pulled down on the heads of the New York bankers who said this week that they expect the Latin American debt to be slowly but successfully refinanced as "we get a better picture of what Volcker will do," and saw the sterling diversification push as "ridiculous"

West German bankers for their part are now confronted with a legislative proposal for consolidated balance sheets and credit surveillance designed to help contract their international lending. West Germany is the "swing vote" on activation of the European Monetary System gold-backed credit expansion plan. French policymakers are on balance more progold and less tolerant of intense austerity for the LDC's. Frankfurt continues to claim that the monetarist-minded Bundesbank is a formidable obstacle to full EMS credit operations, and in short appears, or chooses to appear, to be waiting to thrash out the international development fund option until the Federal Reserve has actually thrown the Euromarkets into a tailspin.

—Laurent Murawiec, Wiesbaden, Susan Johnson, New York

What you should know about gold

If you read Executive Intelligence Review regularly, you know that this publication has had by far the best record of predicting major gold price developments in recent months. In early August, when many respected U.S., British, and Swiss gold analysts were predicting a gold market collapse, we were instructing our readers to prepare for further upward movements. What's our secret? We know that gold is primarily a *political* question, and that what *governments* do is the key to understanding today's markets.

Executive Intelligence Review has put together a 40-page special report to give you all the background information you need to put this method to work in planning your investment strategy. "How does the European Monetary System work and how has it remonetized gold?" "What does gold remonetization mean for the U.S. economy and the dollar?" "How do the European gold proposals differ from the pre-1914 gold standard?" All these questions and more are answered in an easy-to-read question and answer format. The report also includes important policy statements by European officials not generally available in the U.S. press. As an added feature, we present a history of the events leading up to U.S. rejection of gold on Aug. 15, 1971, and who was responsible.

To receive your copy of "Gold Returns to the Monetary System," please send $50.00 by check or money order to *Executive Intelligence Review*, Fifth Floor, 304 W. 58 Street, New York, New York 10019.