Foreign Exchange by Renee Sigerson

Dollar in the barrel?

The long-awaited cut in sterling interest rates won't help the dollar very much at all.

When British Chancellor of the Exchequer Geoffrey Howe announced a 2 percent cut in Britain's Minimum Lending Rate (MLR) on Nov. 24, it appeared as if the U.S. dollar could have strongly benefited from this development.

On the contrary; within hours of Howe's announcement before Parliament, leading London and New York bankers put out the word that the dollar is the most vulnerable currency around, and that a dollar crisis may be just around the corner.

Although such predictions must always be taken with a grain of salt, the leading bankers in question are throwing down the gauntlet to the Reagan transition team: if a convincing U.S. anti-inflationary policy is not adopted, then the dollar will be hit during 1981. What these circles consider a convincing anti-inflationary policy, moreover, is nothing less than the harshest British-style shutdown of the U.S. economy.

The MLR cut announced on Nov. 24, which reduced Britain's equivalent of the discount rate from 16 to 14 percent, was several months in the making. For months leading up to this reduction, sterling and the dollar shared the role as the two highest-interest-rate currencies among the leading industrial countries.

A few hours after Howe mandated the cut, British banker David Montagu, chairman of Merrill Lynch International, held a press conference to explain why the reduction in the MLR would not lead to any major speculative outflows out of sterling.

Currency traders had been concerned about the possibility of a dramatic downturn for sterling, being well aware of the fact that the market strength of the dollar and sterling (for example against the battered West German mark) had been based on interest-rate earning differentials for many months.

Speaking from New York after addressing a conference sponsored by the *International Herald Tribune,* Montagu stated that any potential weakness in the pound would be a very short-term tendency. The pound is a "petrocurrency," he added, making it stronger than would be justified by Britain's trade performance.

Montagu then stated that it was the dollar which was "chronically weak," currently propped up by high interest rates alone.

The pound dropped 2 cents on Nov. 24 on international markets. On Nov. 25, it recouped back to $2.35. While no one expects it to recover to the $2.45 range it touched during recent currency attacks against the West German mark, British banking and industry have no interest in keeping the pound at those levels in any case. The lowered pound exchange rate will now marginally promote British exports.

Other economists attending the New York conference endorsed Montagu's views in interviews circulated the same day. An analyst from Goldman, Sachs, for example, told the press that it is the dollar which is now viewed as a "suspect currency."

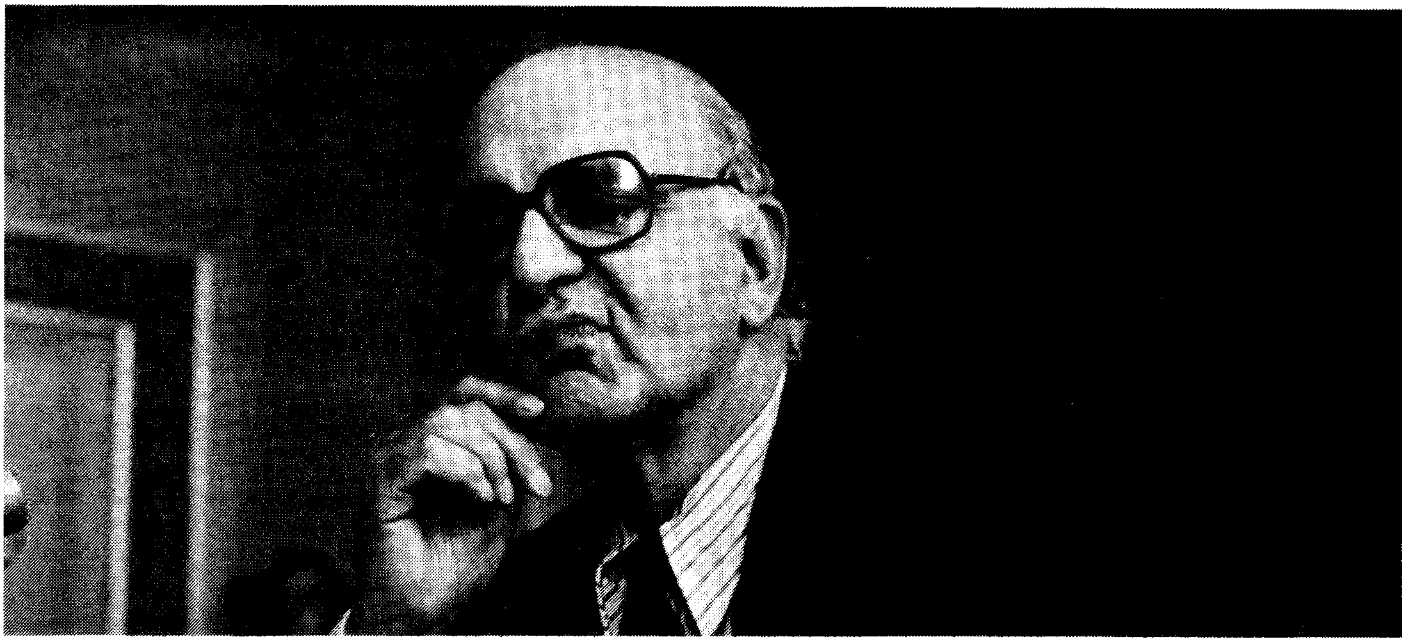
One of the short-term developments that coincided with the MLR cut, and reinforced the perception that the dollar faces tough times, was the Nov. 25 announcement of U.S. money-supply growth for the latest reporting period, ending Nov. 12.

The figures showed that for the first two weeks of November, M1-B grew a whopping $5 billion. The release of these figures undermined confidence in the dollar to an extent sufficient to "pad" the downward adjustment in the sterling exchange rate.

With British interest rates falling, monetarist economists are now saying that it is money-supply growth in itself, apart from interest rate differentials, which will test currency viability in 1981.

For example, the Heritage Foundation has just handed over to Reagan's transition team a policy recommendation document which states that if the explosive U.S. money-supply growth is not brought to a halt, the dollar is finished as the world reserve currency. The document proposes that Reagan impose a zero growth rate on M1-B for his first year in office.

Heritage-circuit economists report that if he adopts the recommendation, the dollar will remain strong. This sort of shock treatment, though, would shut down the U.S. economy even faster than Sir Geoffrey Howe has managed to shut down Great Britain's.



"Watchful observers tend to ask themselves whether Volcker and Miller are merely incompetent or downright insane."

— **Lyndon H. LaRouche**
Contributing editor, *Executive Intelligence Review*

When Federal Reserve Chairman Paul Volcker introduced his credit control policies last year, the EIR was quick to sound the alarm to the danger of "Dr. Volcker's horse liniment." The Volcker package would not be anti-inflationary, EIR warned, but would carry the "Friedmanite stagflation" of the Nixon years to extremes.

Finally, red-faced economists and government officials are now admitting that "something" went wrong.

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