

Foreign Exchange by Kathy Burdman

Deutschemark in the barrel

The Volcker Fed is out to make the Germans deflate, but the Bundesbank has several defense measures remaining.

The West German mark collapsed to a three-year low of DM 2.25 per dollar this week, before being pulled back up to the 2.16 level by major West German central bank interventions. But the troubles of the once-mighty currency and the German "economic miracle" are just beginning.

The U.S. Federal Reserve, under the leadership of Chairman Paul Adolph Volcker, is out to get the deutschemark, it seems. A top New York Fed official told *EIR* this week that in spite of West German Bundesbank Chairman Karl-Otto Poehl's calls for Volcker to lower interest rates and stop the capital flight out of Germany, "There is nothing [the Germans] can do. Volcker went to the Bank for International Settlements this weekend and told Poehl as much flat out."

The Fed now expects the deutschemark to fall back to the DM 2.25 level or below, and has this as a deliberate policy aim.

This same Fed official last October, when the deutschemark was worth 1.80 per dollar (55.5 cents), predicted that by early this year it would fall to 2.25 or 2.50 (40 cents). Apparently, he was in a position to know Mr. Volcker's policy.

"The Germans have come to the end of the economic miracle," he said at the time. "The mark is too high, and the market knows this. You can't start from 1.70 to the dollar and do what they did from 4. The mark was cheap at 4, and they

exported like bandits. And as long as they had low wages enough to keep exporting, they had the best of both worlds. What broke is that they are no longer productive enough to maintain a competitive advantage with wages as high as they are. They are now up against the same rate of technological productivity in countries with much lower wage rates: not only Japan, but Korea, Malaysia, and Brazil."

The official reiterated the Fed's contention that Germany, like the U.S. under Volcker, must deflate strongly to deal with its foreign payments deficit. "Even if U.S. rates were lowered to parity with German rates," he said, "the capital flows coming out of Germany are simply too tremendous."

The only thing that can save the mark is if the Germans "raise their interest rates to follow" the U.S. "They have got to worsen their recession."

Volcker's rather blunt line has already gone out across the foreign-exchange markets, which are clearly taking their cue from the Fed. "The Fed will do what it feels it must do to fight inflation, no matter the effect on Germany or the complaints from the German government," traders at European-American Bank said this week. "This is a case of the tail trying to wag the dog."

"If the Bundesbank [the West German central bank] does not start raising its interest rates, the

mark will be in for a bloodbath," the trader said. "The Bundesbank might raise the Lombard rate one-half percent for show, but if that's all they do, forget it. The mark will fall below 2.25. Either the Bundesbank puts Germany into recession, or the mark will get a lot weaker."

I don't think matters are all that simple. First, the Bundesbank has already given a tremendous slap to the deutschemark bears this week with some \$300 million in intervention during the first few days of the week. This alone caused the recovery midweek from the DM 2.25 to the DM 2.16 range.

This intervention comes on top of intervention during the second week in February of over \$600 million, and has already caused many traders to warn that the Bundesbank still has over \$30 billion in foreign exchange at its command with which to singe the speculators.

Moreover, the Bundesbank chiefs could, and probably will, if pressed, easily put together a major deutschemark rescue package with the help of other central banks. Such a package was already mentioned by the London *Financial Times* this week as being under Bonn's consideration. It would be modeled on the Carter 1977-78 dollar measures, with "massive dollar credit swaps" being set up between the Bundesbank, Switzerland, and other central banks, who could not diplomatically refuse such a request.

The last line of defense, and a very substantial one, remains the Bundesbank's gold, which is worth \$100 billion at market prices. As noted last week, Dresdner Bank and others have already suggested a large German borrowing against the gold to support the mark.