Poehl: Germany's Volcker?

Has the head of the Bundesbank gone crazy, Frankfurt bankers wonder, as the credit markets gyrate.

Karl-Otto Poehl, head of the West German Bundesbank, indicated his complete understanding of and agreement with U.S. monetary policy in meetings with U.S. officials in Washington last week, reports the *Neue Zürcher Zeitung.* Belying his recent public expressions of concern over the difficulties that high interest rates in the U.S. were causing the German economy, Poehl went out of his way to explain and justify both the present U.S. high rates and the policies he has implemented in Germany, which have already raised German interest rates significantly and introduced a degree of volatility to the German money markets that German bankers regard as ruinous.

Poehl is reported to be very unhappy with the strong attacks on American interest-rate policy emanating from Bonn, in particular from Chancellor Helmut Schmidt, who has made it clear in repeated interviews over the past two weeks that he regards U.S. interest rates as destructively high. Schmidt has argued that high U.S. rates compel other countries to raise their interest rates in order to prevent mass capital outflows, and that this in turn causes severe economic restriction unrelated to domestic requirements.

Poehl told Washington he regards the recent sudden jump in German interest rates caused by Poehl's decision to hike the Lombard rate (the rate at which banks borrow against securities holdings at the Bundesbank) by 33 percent to be the direct result of Germany's high current account deficit. According to the *NZZ,* for years Poehl has been recommending that other countries with current account deficits impose similar restrictions, and now he is "taking his own advice to heart." Thus, Poehl has signaled that he agrees with U.S. Federal Reserve Chairman Paul Volcker 100 percent on the propriety of both U.S. and German high interest rates, despite their manifest *inflationary* effect.

Poehl further defended this package of measures—deregulating the Lombard rate and taking a flexible stance toward the needs of German banks to get refinancing from the central bank—by saying it was the only alternative to "very severe austerity" (i.e., depression) later, and said the Bundesbank was doing everything possible to prevent the latter eventuality.

The real story of what Poehl is up to, however, was told on the current West German currency markets the first week of March, and by worried German bankers behind closed boardroom doors.

Defying the law of gravity, and the law of rational currency trading, the deutschemark fluttered wildly against the U.S. dollar all week, most recently falling from 2.17 on March 2 to 2.12 March 3, for no solid reason. Such day-to-day instability, as Poehl and every apprentice banker in the world knows full well, wreaks havoc on foreign trade and all transactions that involve currency exchange.

Meanwhile, German bankers have begun climbing the walls. Poehl is "going crazy" according to one well-placed banker in Frankfurt who reflects the majority sentiment, and Poehl is, "to vastly understate it, being rather erratic," closing the Lombard window one day, opening it the next, jacking rates the third, and so forth. Bankers distrust Poehl, he added, because Poehl "won't listen" to them.

In short, the Bundesbank's policy is designed to provoke total market instability. Whether the mark ultimately falls or rises is of secondary interest to Poehl. If this instability is allowed to continue, it will, among other things, halt all deutschemark lending to the Third World, a goal Poehl has publicly endorsed.

The exchange rate chaos is so great, in fact, that it has already become grist for the strict monetarists' mill. Eugene Birnbaum, head of The Securities Group , a U.S. arm of the Siena banking group and a notorious advocate of a deflationary return to a strict gold standard, last weekend decried the exchange rate instability between the dollar and mark, citing it as a strong argument for the Siena group's nostrum for all economic ills.

Given that any such deflationary medicine can only cause a sharp depression, Birnbaum's proposal is to jump from Poehl's frying pan into Siena's fire.