Foreign Exchange by David Goldman

Patchwork in the EMS

François Mitterrand's economic rampage means the present rate structure cannot hold for long.

The Oct. 4 revaluation of parities in the European Monetary System (DM up 5.5 percent, French franc and lira down 3 percent) does not do much more than to demonstrate the willingness of postwar Germans to stall in face of major decisions. Treasury Undersecretary Beryl Sprinkel's public warning Oct. 4 that this will not be the last revaluation is unfortunately accurate; the French franc is temporarily strong only due to fierce exchange and credit controls, but should tumble by early in 1982.

Chancellor Schmidt gave a major concession to François Mitterrand, by letting the DM take the brunt of the shift. For obvious political reasons, Mitterrand did not want to combine a major franc devaluation with the Oct. 2 announcement of a budget that adds 65,000 makework jobs to the French government payroll. All economic logic pointed to a devaluation of the franc, which would have collapsed but for about $5 billion in Banque de France intervention since Mitterrand's May victory. However, Schmidt "took French internal political factors into account," and gave Mitterrand the formulation he wanted.

One Deutsche Bank economist had predicted the result a week earlier, explaining that while the prevailing view in Germany was that the French economy would collapse under the Mitterrand economic program, the Germans nonetheless figured cynically that they could get another year's worth of exports out of France before it went under. Even so, the VDMA, the German machine-builders' association, and other groups note that the currency shift will certainly prejudice German exports within the EMS area, Germany's major market.

At present, the decline of the German economy has been stabilized (but not really corrected) by a 5 percent drop in import volume and a 3 percent growth in export volume this year—a combination of austerity and an export drive. The conditions under which this occurred were adverse; world trade will probably come in at 4 percent lower this year than last. In other words, Germany, taking advantage of the cheaper DM, pushed more of the trade decline onto other countries, e.g. the U.S., the big loser in world export markets—which was no more than the U.S. had provoked by driving the dollar up to a five-year high through record short- and long-term interest rates.

However, senior German officials came away from the Sept. 28-Oct. 2 IMF meeting with the grim conviction that the financing of world trade as a byproduct of the Eurodollar lending bubble would not outlast the year. The thrust of the IMF's demands was to reduce the import volume of the Third World in order to spare the international banks further "exposure" to debtor countries who will never pay them back, i.e., to pay debt service through import reductions.

German banks are already withdrawing from dollar lending to borrowing countries, and concentrating on financing suppliers' credits from German companies exporting to the Third World. The shift to export financing of this type, away from Eurodollar syndications, implies—if it extends to Germany's Third World exports—much greater mark reserve.

A shift to dependence on the country's own currency implies a basic disagreement with at least the Saudis, the Japanese, and others who have some say in the disposition of reserves, otherwise the German banks will only succeed in overextending their own nation's currency, with equally dangerous effects. The coordination of foreign exchange market intervention with Japan has been an active topic of discussion since the German and Japanese finance ministers met privately during the Ottawa conference, although both sides are keeping close wraps over the talks.

In short, the Germans, for all their temporary export success, face not only the certainty of a rising mark, but the need to evolve entirely new approaches to trade financing. One German banker pouted, "we are worrying more about exports to Denmark than to Latin America."

The Oct. 4 revaluation is a symptom of this sort of mood. The Oct. 22 North-South deliberations at Cancún should provide some insight into the Germans' ability to strike a deal with the Japanese and others. Not much later, new devaluation pressures against the French franc will become evident.