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Foreign Exchange by EIR Staff

Bonn, Tokyo won't prop up dollar

America's economic suicide should not become an international pact, West Germany and Japan agree.

Months of top-level international meetings, from the Sept. 22, 1985 meeting of the Group of Five finance ministers at New York's Plaza Hotel, through the May Economic Summit in Tokyo, turned to dust on Aug. 21 and 22. The White House on Aug. 21 issued, through presidential press spokesman Larry Speakes, an official demand that West Germany and Japan lower interest rates, in coordination with the Federal Reserve's lowering of the U.S. discount rate to 5.5% on Aug. 20.

On Aug. 22, the West German Bundesbank issued a blunt statement to the effect that West Germany's central bank would not bow to outside pressures upon its monetary policies.

That leaves the dollar positioned for a collapse better resembling the destruction of the British pound under the Callaghan government in 1976-77, than the previous collapse of the U.S. dollar during 1978. Britain, before North Sea oil came on line, relied upon foreign deposits held in British pounds to finance its trade deficit.

Reluctance of international hot money to remain in sterling, given the collapse of the British economy, forced England to raise interest rates to 18%, a peacetime record exceeded three years later by Fed Chairman Paul Volcker, to keep funds in the country.

The U.S. dollar now stands at just over DM 2.04 and yen 153, a six-year low in Frankfurt, and a postwar low in Tokyo. There is nothing to stop the dollar from falling well below its 1978 bottom of DM 1.78.

Since the United States depends upon short-term capital inflows to finance its annual $170 billion trade deficit, a collapse of the dollar will ruin American capital markets, precisely when dollar markets face their worst crisis in history.

On the surface of events, the Federal Reserve on Aug. 20 panicked in the face of lower economic growth, after the Commerce Department announced that "real" Gross National Product had grown by only 0.6% during the second quarter.

The economic reality is much worse (see *Domestic Credit*), and the financial reality is even worse than that. The 91st U.S. bank failure this year occurred the same day. The Federal Deposit Insurance Corporation is running out of tricks to keep insolvent banks afloat.

Worse still is the position of the major U.S. international banks, of which the 15 largest have accumulated more than $1.25 trillion in "off-balance-sheet liabilities," offering loan-guarantees and similar forms of risk-exposure, in return for up-front fee income.

Peru's rejection of the International Monetary Fund brings the developing-sector debt crisis to the forefront, at the moment that the oil price-collapse is scything down oil-patch financial institutions, and the new tax reform legislation threatens to pop a $250 billion real-estate lending bubble.

Germany and Japan are being asked not to stimulate economic activity, but to bail out the bankrupt U.S. banking system.

Since the U.S. administration, through the present tax bill, Gramm-Rudman, and related programs, insists upon tearing down the facade of economic recovery, and accelerating the decline of U.S. physical production, there is no reason for Bonn or Tokyo to suspect that Washington is remotely interested in stimulating economic growth.

They have good reason to suspect that Washington wants them to mortgage their national currencies to reflate the American banking system.

Since Washington, under the continued policy-guidance of Secretary of State George Shultz and White House Chief of Staff Don Regan, supports the IMF against Peru and its Ibero-American allies, they also have no reason to suspect that Washington intends to settle the debt crisis in any sensible way.

It is no surprise, under the circumstances, that West German central bank spokesman Claus Koehler Aug. 22 responded to Reuters news service's question about the White House dictates concerning German monetary policy, "That we are going to do in peace. We have never let ourselves be influenced by pressure—either a pressure from inside or outside."

Regarding the collapse of the dollar, continuing on foreign-exchange markets, Koehler told Reuters, "We have accepted the lower dollar rate and done nothing against it."

A week earlier, the governor of the Bank of Japan, Satoshi Sumita, said that Japan had no intention of lowering interest rates.

In any event, it is folly to believe that lower West German or Japanese interest rates would have any impact whatever on economic activity, or anything other than a temporary effect on the dollar's exchange rate.

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