Foreign Exchange by EIR Staff

Banking trouble and the dollar

Rumors about the collapse of Bank of America start the new ratchet-decline of the U.S. currency.

Last week in this space, *EIR* warned that the singular situation of the foreign-exchange markets would lead to a renewed descent of the U.S. dollar, following weeks in which the dollar hovered just above the two-deutschemark line. The dollar rose in the week of Sept. 8, as the bond and then the stock market crashed, to about DM 2.08. The foreign-exchange market, as usual, misread the importance of the week's developments, and simply followed the upward curve of U.S. interest rates into the U.S. currency.

However, by Sept. 17, the dollar fell to about DM 2.04, apparently because of rumors that the nation's third-largest bank, Bank of America, was about to enter bankruptcy proceedings. The rumor was not true; on the contrary, the fact that Bank of America was able to peddle a $620 million real-estate holding to a Japanese investment group demonstrated that it could still raise cash. But the fact that a Japanese buyer came along with the cash reflects the vulnerability both of Bank of America and the U.S. dollar in general.

The federal deficit could easily pile up over $300 billion, over one-third of total tax revenues—a figure that swamps the imagination, larger even than America's illegal narcotics traffic.

What do the administration and Congress propose to do about this? Tax a few billion from cigarette sales, gouge an extra $11 billion from tax reform, and raise $6 billion with an 8% tax on gasoline.

The creditors of the United States, to whom we now owe close to $200 billion net, will not be impressed by this exercise. They are already financing most of our present $230 billion deficit, and Wall Street threatens to have a fit every time the Japanese investment houses are not first in line at auctions of Treasury securities.

"In 1985, proceeds from Japan's ever-widening account went into U.S. Treasury bonds, but recent U.S. Treasury data seem turnaround," says a recent report from Salomon Brothers. Net purchases of U.S. bonds by Japanese investors amounted to a relatively paltry $8.9 billion annual rate in the first six months of this year—a dramatic slowdown from the record $24.3 billion pace of 1985. Data obtained from Japanese sources tell a different story. Instead of plunging in the first half of the year, net purchases of U.S. bonds, according to the Japanese figures, soared to an estimated $63 billion annual rate. Large discrepancies between U.S. and Japanese reporting of these purchases are common, but this one is by far the largest. American statistics probably do not report securities purchased by Japanese institutions outside of Japan, as a Japanese purchase.

Not only the Japanese, but other industrial nations who subsidize the U.S. economy, including West Germany, take the money they earn selling $220 billion a year more to the United States than the U.S.A. sells to them, and invest it in dollar securities of some kind. In other words, the trade deficit finances the budget deficit. How long that insane arrangement can continue is not for us to specify at the moment; however, the fact is that Japanese funds came into the United States this year at more than double last year's rate.

That is why the Federal Reserve has been able to lower interest rates, which, in turn, has prevented the real-estate market, the savings banks, and other big chunks of the U.S. financial system from crumbling like so much rotted stucco.

America's response to the horrified protest of our trading partners and creditors, has been to demand that these partners simply print more money, and turn it over to the U.S. Treasury and U.S. banks. It is not only the Treasury deficit that the Japanese are supposed to finance; after Fed chairman Paul Volcker and Treasury Secretary James Baker III went to Mexico to jerry-rig that nation's $100 billion external debt, they demanded that the Japanese banks lend Mexico the biggest share of new money needed to pay this year's interest.

Understandably, the Japanese have no interest in destroying their own banking system, let alone their currency, on behalf of Washington's fiscal fantasy life. At this point, it is irrelevant whether the Japanese and West Germans cave in to Washington's demands that they join a general reflation. If not Bank of America, then other major institutions will continue to fail at an uncontrollable pace, and Washington's demands for funds to bail them out will escalate faster than any global reflation plan might accommodate.

The decline in U.S. interest rates since April 1985 merely postponed the day on which the Federal Reserve would have to monetize the bad debts of the nation's banking system, and push the dollar well below its present weak level.